

# THE HAIG REPORT<sup>®</sup>

TRENDS IN AUTO RETAIL AND THEIR IMPACT ON DEALERSHIP VALUES

## SECOND QUARTER – 2018

- The number of dealerships sold in Q2 jumped 87% compared to Q2 2017, perhaps due to the new tax code and more sellers coming to market with realistic expectations
- The number of dealerships sold in H1 is up 23% compared to H1 2017
- Public company spending on US dealerships is about even with H1 2017
- Blue sky multiples are constant overall, with a few changes for individual franchises
- Industry sales remain surprisingly healthy, although dealership profits continue to slip due to rising costs



# OVERVIEW

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## “And The Beat Goes On...”

The auto retail industry continues to provide surprisingly good results for dealers. Many analysts had been predicting lower sales and higher inflation, which could have been a double blow to dealers' profits. But sales have been stronger than expected and dealers are finding ways to offset higher expenses. While profits have declined about 9% from peak profits in 2016, they are still far higher than they were prior to the Great Recession.

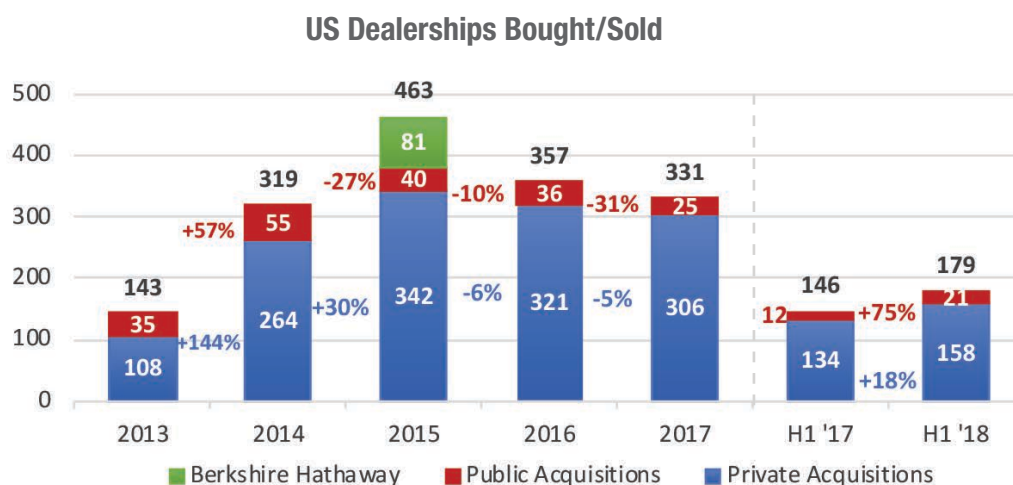
The buy-sell market boomed in the second quarter, perhaps as a result of more sellers coming to market and meeting buyers with more cash to spend thanks to a tax cut that benefitted both public and private companies. We had been expecting to see a meaningful decline in prices for dealerships in general due to an overall decline in auto retail and all the discussion about the risks that autonomous vehicles and electrification poses to auto retailers, but so far our data indicates that overall pricing is unchanged. There have, however, been changes in pricing for a handful of franchises due to conditions specific to them.

We have noticed a couple of new or accelerating trends. First, the number of groups who are pursuing a Get Big or Get Out strategy seems to be increasing. And some are exploring “mergers” as a way to help finance the growth and reduce the risk of acquisitions.

We expect to see a very active buy-sell market in the second half of 2018 based on conversations we have had with buyers, bankers, lawyers, CPAs and the high level of activity we have in our own practice. The market has evolved in 2018 to become more of a buyer's market than in previous years since there are more stores available for sale, and pricing per dealership has fallen about 9% since the peak in 2015.

## The Buy-Sell Market Exploded in the Second Quarter

With 86 stores trading hands in Q2 2018, the number of dealerships sold jumped 87% compared to Q2 2017, according to the [Banks Report](#) and Haig Partners' data. This burst of deal activity is after a slight downturn in the number of dealerships sold in Q1 2018 compared to Q1 2017. For the first six months of 2018 there has been a 23% increase in dealerships sold compared to the first half of 2017.



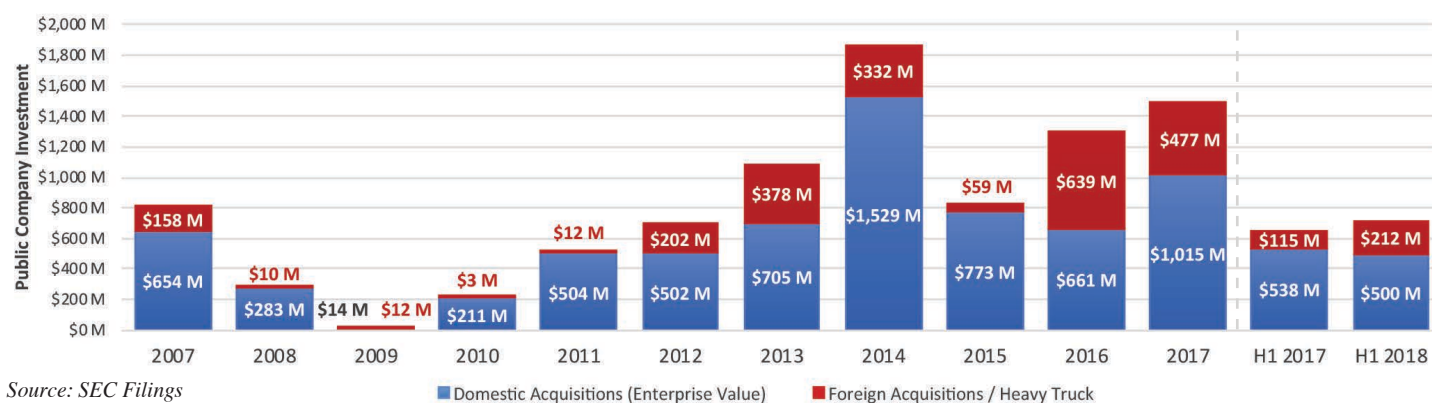
Source: The Banks Report and Haig Partners

Domestic stores made up 45% of volume in H1, flat from 45% in H1 2017. The share of luxury stores that sold increased slightly, making up 17% of volume in H1 2018 compared to 15% in H1 2017. Import stores comprised 38% of dealerships sold in Q1 2018 compared to 40% in H1 2017. These are relatively small shifts and the year is just halfway over, so it is too early to know if there are any meaningful changes in buyers' tastes.

The public auto retailers spent \$500M on domestic dealership acquisitions in H1 2018, a slight dip from H1 2017, but still the second highest first half spend in the last five years. Lithia remains the most active, including its acquisition of Prestige Family of Fine Cars (a Haig Partners client). Asbury also maintained its acquisition spending during Q2, including purchasing an Atlanta area Toyota dealership which was also a Haig Partners client. The public companies benefited significantly from the tax cuts with their rates falling from the high 30% into the low 20%. And the public retailers are also very active on the divestiture side, shedding stores that do not provide them with a satisfactory return on capital. Sonic Automotive generated \$122M in proceeds from dealership sales, which it said it planned on reinvesting in its Echo Park used car division.

## Public Company Acquisition Spending

(Domestic and International)



Based on the data so far in 2018 and our own transaction pipeline, we are expecting a strong second half in the buy-sell market in 2018. Some dealers are opting to jettison franchises in which they have lost confidence. Older dealers without succession plans are looking to exit while dealership values remain strong. And we now have more clients in the prime of their careers who are choosing to sell today since they are concerned about the future of auto retail, whether it be the high capital requirements, the growing control of the OEMs on dealership profits, or the potential risks that new technology present. And there is an increasing conviction that scale will matter more in the future than it has in the past.

## HAIG PARTNERS: PROVIDING VALUE TO CLIENTS

We combine the skills gained during our years in investment and commercial banking with the experience of buying and selling dealerships for AutoNation and Asbury. Haig Partners is not a traditional dealership brokerage firm. We do not seek "listings" of many dealerships. Instead, we provide the best possible advice and service to a limited number of clients, helping optimize the sale of their most valuable asset. We spend a tremendous amount of time and energy on each engagement. Emphasizing quality over quantity best serves our clients' interests.

**Relationships with Buyers.** We know many of the best buyers across the US and understand what they want to acquire, what their ability is to close, and how they negotiate. By targeting specific buyers instead of running ads, we preserve confidentiality and close transactions more efficiently.

**Higher Prices.** We create offering materials that provide buyers with a compelling investment thesis about why they should acquire our client's business instead of other opportunities. We then run a process that creates competition to generate highly attractive offers from buyers.

**Experience.** Since we have been involved in 170 transactions for 290 dealerships with over \$4.0 billion in value, we know how to respond to issues that can arise in a buy-sell process.

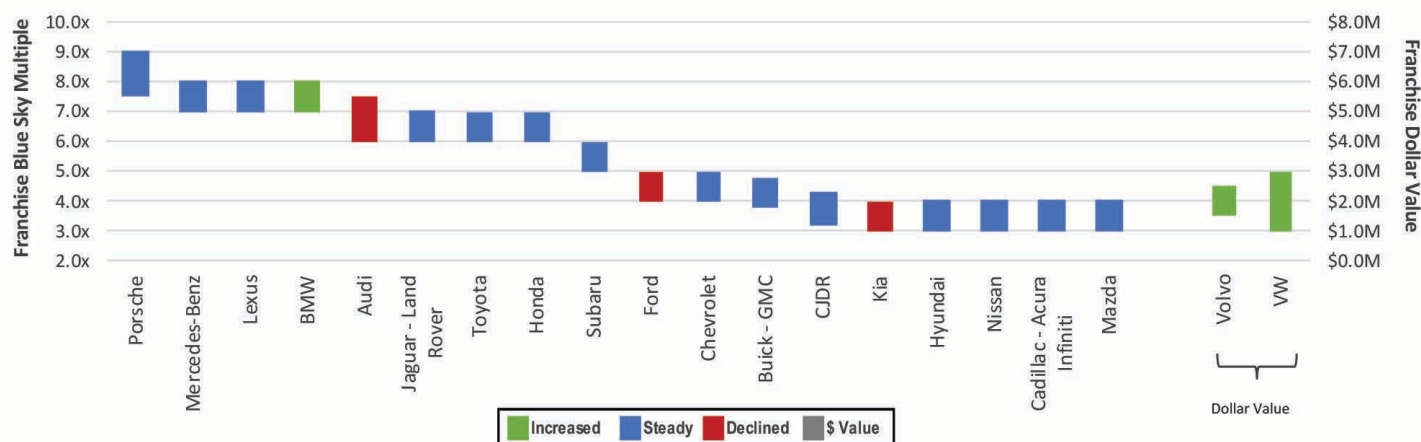
**Speed.** We focus on the transaction every day, allowing our clients to focus on dealership operations.

## Blue Sky Multiples Are Moving in Mixed Directions

We have been expecting a decline in blue sky multiples for two reasons. First, dealership pre-tax profits have been falling for a couple of years and many expect they will continue to decline. Second, the number of dealerships for sale has increased markedly, giving buyers more choices. But so far in 2018, we have not seen a decline materialize. There may be several reasons that blue sky multiples remain healthy, including lower taxes, increased buyer confidence due to healthy macroeconomic conditions, and the fact that almost every other asset class is trading at high prices. That said, blue sky multiples have moved slightly for a number of franchises due to reasons exclusive of those franchises, and not the overall market.

The table below provides our estimate of what multiple or value a 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 addition to the other assets. The blue sky multiple is partly a reflection of the risk/reward profile that investors place on each franchise. Higher risk franchises command lower multiples, while franchises that are perceived as lower risk bring higher multiples. The net result is a risk-adjusted return profile as determined by the market. Of course, actual multiples or prices paid by buyers could be higher or lower than the ranges we indicate. Stores that are not marketed properly and dealerships with facility issues will bring lower multiples. Underperforming dealerships can bring much higher multiples. Metro stores typically bring higher prices than stores in rural areas. Dealerships in states with no income tax usually bring premiums to dealerships in high tax states. In other words, each store is unique and brings its own set of opportunities and challenges. We caution readers not to view these values rigidly.

Haig Partners Blue Sky Multiples



## HAIG PARTNERS SPOTLIGHT:



## STUART MCCALLUM, VICE PRESIDENT

For nearly a decade, Stuart has provided transaction advisory and consulting services to North American dealerships, representing automotive, RV, boat, truck, and heavy equipment. Serving many top 150 automotive dealership groups and their advisors, Stuart has worked with buyers and sellers to provide professional advice in executing their growth and financial goals. He has advised on more than \$1 billion in transactions. In addition, Stuart has completed valuations on over 600 dealerships so he has a keen understanding of market values.

Prior to joining Haig Partners as a Vice President, Stuart worked with the retail dealership services practice of Crowe Horwath, the 8th largest accounting firm.

Stuart has earned a Bachelor of Science in Economics and a Master of Science in Finance from DePaul University in Chicago.



# TRENDS IMPACTING AUTO RETAIL

## Overview

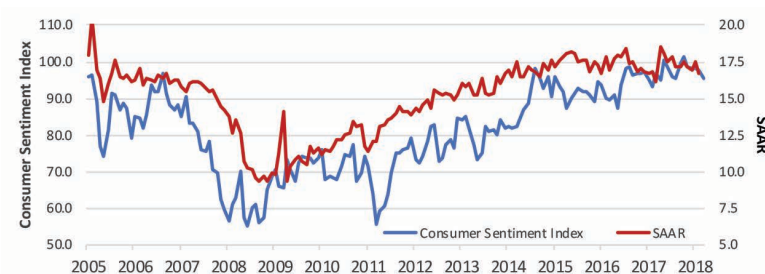
Most dealers we have spoken with were pleased with the first half of the year. Retail sales remain strong, taxes were cut, and profits are healthy. While current conditions are robust, several dealers have told us they believe the second half of the year will be more challenging. They are increasing their emphasis on used vehicles, F&I and fixed operations. And they are focused on their expenses, trying to reduce advertising, floor plan and compensation costs.

## Macroeconomic Indicators Are A Mixed Bag

We are beginning to see some mixed signals from the economic indicators that impact the auto retail industry.

- **GDP Is Growing.** GDP accelerated from 2.2% in Q1 to 4.1% in Q2, the highest since Q3 2014. GDP growth is projected to be 2.9% for all of 2018 according to the Conference Board. This healthy growth can help sustain sales and profits in the auto industry.
- **Employment and Household Income Are Increasing.** The US added over two million jobs in each of the last six years and 2018 is trending to be another strong year. In fact, the pace of hiring has been accelerating almost every month this year. The unemployment rate in July stood at 3.9%, the lowest rate since 2000, and was 2.2% for college graduates. We are essentially at full employment. As a result of the tighter labor market, wages grew 2.7% through July 2018. These higher wages can help offset rising fuel prices and interest rates for consumers.
- **Consumer Sentiment Remains High.** Consumer sentiment remains near high levels, but has stalled due to concerns about rising prices.
- **Number of Miles Driven Is Increasing, But More Slowly.** The total number of miles driven, which influences the vehicle replacement rate and is a key measure of demand for autos, continues to increase through May 2018 by 0.7%, a slower growth rate than the 1.3% in 2017 and 2.4% from 2016 according to the US Federal Highway Administration. This flattening measurement is part of the pressure we are feeling on new and used vehicle sales and margins.
- **Gas Prices are Rising.** The Department of Energy reported that the average price per gallon of fuel was \$2.84 through early August 2018, a 19.3% increase over the same period in 2017. Higher fuel prices reduce discretionary cash for auto purchases.
- **Interest Rates Are Increasing.** The Fed increased interest rates by 0.75% in 2017, 0.5% so far in 2018, and is expected to raise rates by another 0.5% before the end of the year. These increasing rates hurt dealers due to higher floorplan costs and mortgage expenses on floating rate loans. We have seen net floorplan go from a boost to income to an expense. And of course, they suppress consumer demand for vehicles as average loan and lease payments increase. The Wall Street Journal has reported that the average car payment has increased 4.8% since January 2018, greater than inflation.
- **Lending Standards Are Tighter.** Over the last 12 months, banks have tightened standards for sub-prime borrowers by requiring higher down payments and credit scores, raising rates, and reducing 84-month loan availability. Tighter credit is another contributing factor to the headwinds some dealers are facing today.

Consumer Sentiment Versus SAAR



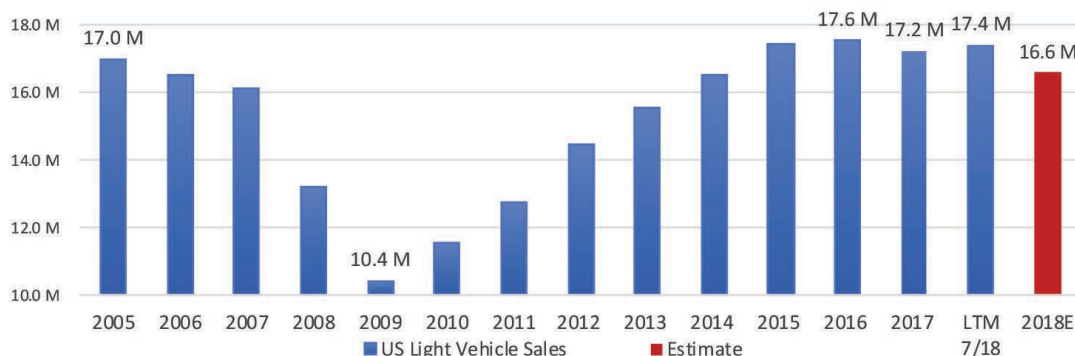
Source: Thompson Reuters / University of Michigan; Automotive News

## TRENDS IMPACTING AUTO RETAIL

### New Unit Sales Remain Elevated, Surprising Many Forecasters

Over the last twelve months SAAR has been running at 17.4M units which is very close to the highest level of sales that we reached back in 2016 and is higher than 2017 sales. These results have surprised most analysts who had been predicting a meaningful decline in sales for the year. The 16.6M forecast for 2018 shown below is an average of nine forecasts released over the last few months that range from a low of 16.0M to a high of 17.0M. If sales continue at this pace, analysts will need to revise their forecasts higher.

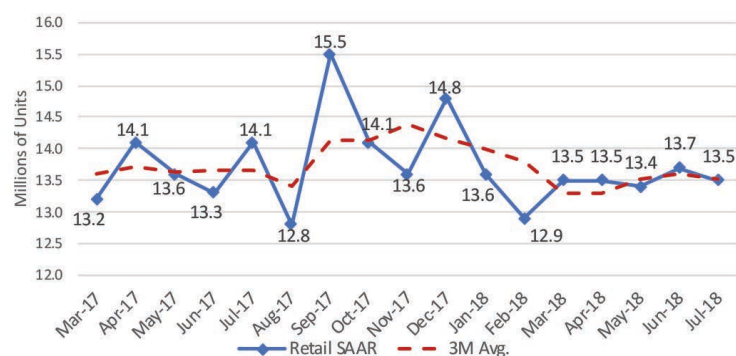
#### US Light Vehicle Sales



Source: Historicals - Automotive News, Estimates: NADA, IHS, Bank of America/Merrill Lynch, Edmunds, Ward's, Moody's, Cox, Morgan Stanley, LMC/JD Power

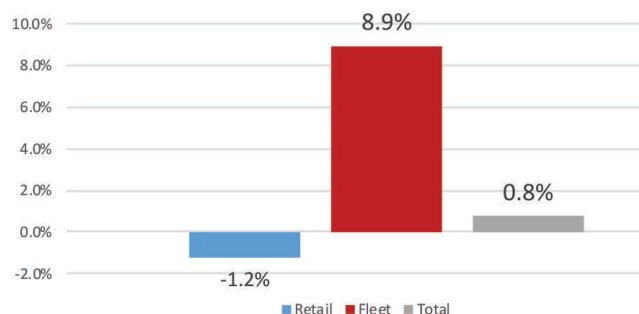
Note the data above is for total new vehicle sales, including fleet sales. According to data from JD Power, retail sales through July are down 1.2% from last year and fleet sales were up 8.9%. Dealers are still basically selling the same number of vehicles they did in 2016, but are facing a different environment with lower margins and higher expenses.

#### Retail SAAR



Source: JD Power

#### Y/Y Sales Change - YTD July 2018



Source: JD Power

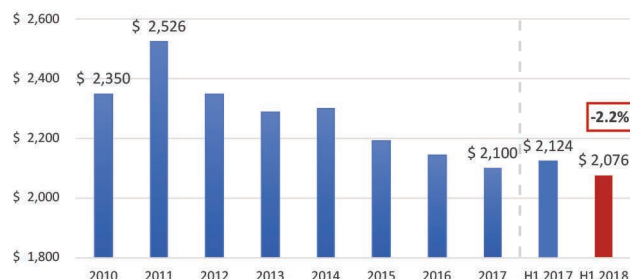
### Vehicle Grosses Stabilize – A Bit

New vehicle profits continue to slide, though at a slower pace, down an average of 2.2% so far in 2018 for the public retailers. This trend has been frustrating many retailers, but there may be a light at the end of the tunnel as Lithia and Penske managed to deliver small increases. These increases were due to a number of factors, including an improved mix of cars and trucks/SUVs/CUVs, and some production cuts by the OEMs. Is it possible we could be nearing the bottom of new vehicle margins?

As for used vehicles, the average gross profit per used vehicle rose 1.1% for the publics in H1 2018. These figures may be misleading, however, as AutoNation and Penske were the only two public companies with increases in used vehicle profits. AutoNation is enjoying comparisons to a very difficult Q1 2017 when it introduced one-price selling and dumped many stop-sale vehicles held over from 2016. And Penske is reporting data that includes its used car stores that carry higher margins than what it generates on used car sales at its franchised locations.

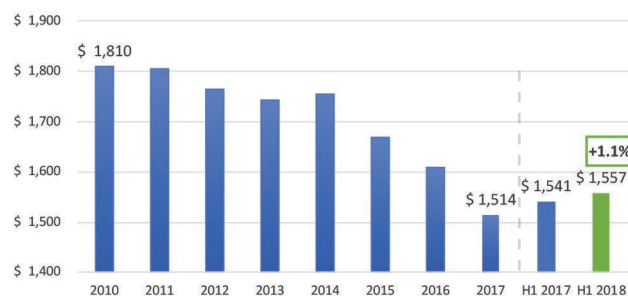
## TRENDS IMPACTING AUTO RETAIL

### NEW Gross Profits Per Vehicle: Public Company Data (Weighted Average Same Store Performance - in Current Dollars)



Source: SEC filings

### USED Gross Profits Per Vehicle: Public Company Data (Weighted Average Same Store Performance - in Current Dollars)



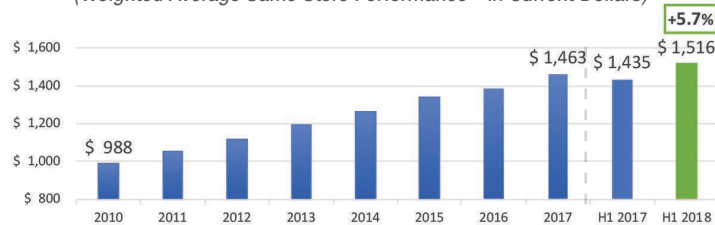
Source: SEC filings

## Finance & Insurance Departments Are Generating Record Profits

F&I profits per vehicle retailed broke through \$1,500 for the first time. In H1, the public groups reported gross profit per vehicle retailed reached \$1,516, up 5.7%, or \$81 per vehicle, from H1 2017. This increase more than offsets the declines in gross profit on new vehicles. A number of private dealers have disclosed they earn even higher profits than these figures, some over \$2,000 per vehicle retailed.

### Public Company F&I Per Unit Retailed

(Weighted Average Same Store Performance - in Current Dollars)



Source: SEC filings

## Combined Front and Back: Profits per Vehicle Retailed Are Actually Up

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 dollar terms. Given the rise in new vehicle prices over this time, however, the profit margin as a percent of vehicle sales has fallen steadily.

### Public Company NEW Vehicle Gross + F&I PVR

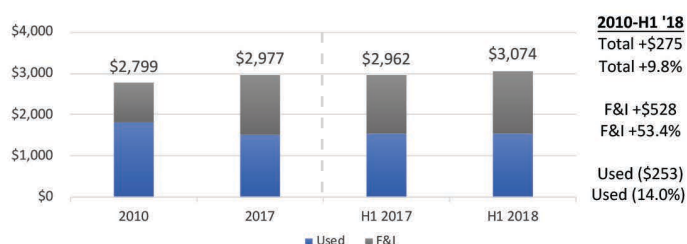
(Weighted Average Same Store Performance - in Current Dollars)



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

### Public Company USED Vehicle Gross + F&I PVR

(Weighted Average Same Store Performance - in Current Dollars)



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

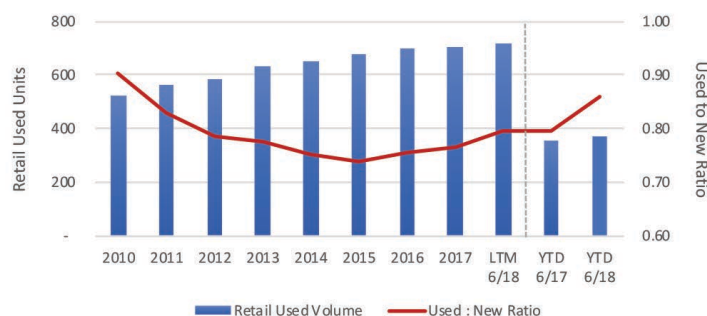
## Used Vehicle Market Is An Opportunity For Growth

As the new car market begins a period of flat to declining retail sales, a number of dealers have told us they are increasing their focus on used vehicles. And there is plenty of room for improvement since franchised dealers account for just 30.1% of total used sales. The supply of used vehicles is increasing and the mix of cars to trucks/SUVs/CUVs is more in line with current consumer demand. Dealers'

## TRENDS IMPACTING AUTO RETAIL

Used to New Ratio is up to 0.86x in the first half of 2018 compared to 0.80x in H1 2017. AutoNation, Penske, and Sonic recognize this opportunity as all of them are pushing for higher volume in their franchised dealerships and are also investing heavily in building out used vehicle only dealerships. They want a bigger part of the 40+ million in used cars that are sold annually in the US, and to lessen their exposure to a downturn in new vehicle sales and declining new vehicle margins.

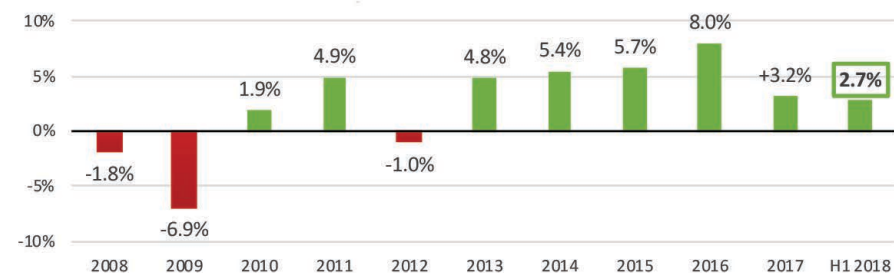
### NADA Average Retail Used Per Dealership



## Fixed Operations Continue to Drive Higher Profits

Private dealers reported fixed operations are up 2.7% in H1 2018 compared to H1 2017. The growth rate in fixed operations appears to be leveling off from the mid-single digit rate that we have enjoyed for the past five years. As the number of units in operation peaks, dealers are likely to find it harder to generate incremental profits from their fixed operations.

### NADA Fixed Operations Growth



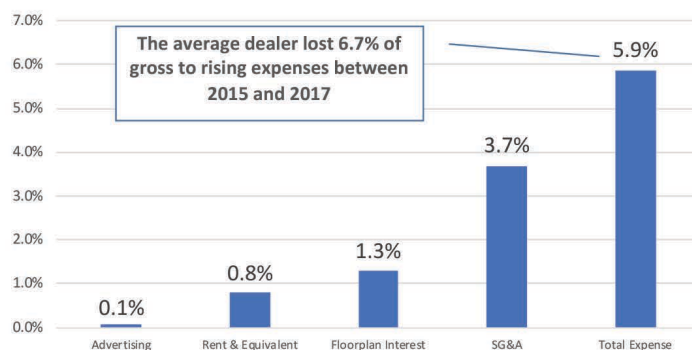
Source: NADA

## Dealership Expenses Are Growing Faster Than Gross Profit

Rising costs appear to be the greatest threat to dealership profits. NADA data shows the average privately owned dealership grew gross profit by 0.6% while its expenses increased by 2.3% in the first half of 2018. Public companies grew their gross profit by 7.1% in the first of this year (partially due to acquisitions), but their expenses jumped 8.3% (per SEC filings, adjusted). Dealers are telling us they are seeing higher costs in floorplan, compensation, and rent (from the many expensive facilities that have been built in recent years, and rising rates). In the first half of 2018 dealers have done a better job managing advertising and SG&A expenses, but are having a hard time overcoming rising interest rates.

### Change in Expense as a % of Gross Profit

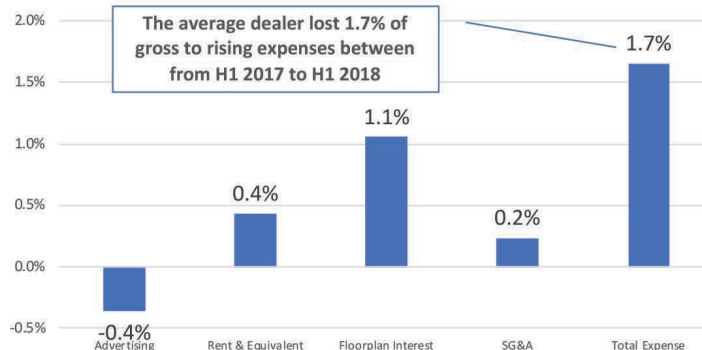
(2015 - 2017)



Source: NADA

### Change in Expense as a % of Gross Profit

(H1 2017 - H1 2018)



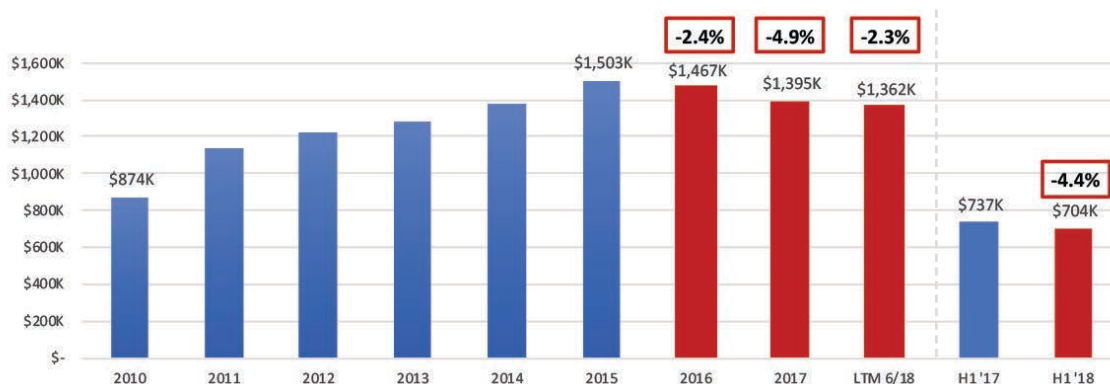
Source: NADA



## Dealership Profits Drop Slightly

The net outcome of the trends listed above is that profits at privately owned dealerships are down 4.4% in the first six months of 2018 compared to H1 2017 on top of a 4.9% decline from 2016 to 2017. Dealers tell us their business feels, “just OK.” Average profits per store have fallen about 9% from their peak in 2015, but this figure can vary widely when you look at how different franchises have performed. For instance, profits per store have fallen significantly at Nissan, Kia and Hyundai, but have increased at BMW, Volvo and VW.

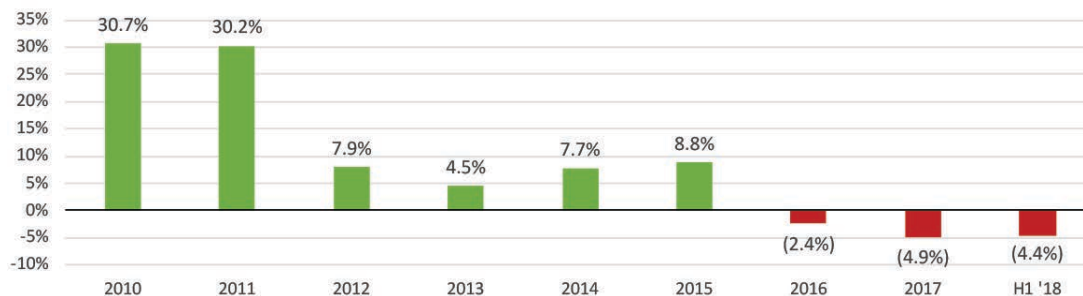
### NADA Average Private Dealership Earnings



Source: NADA

The table below shows the annual *change* in profits at privately owned dealerships since 2009. Prior to the Great Recession, during the 2001 to 2007 period when new vehicle sales were essentially at a plateau, NADA data showed that annual profits per dealership fell by about 5% per year due to falling margins and rising costs until the recession hit in 2008. We may now be entering a similar cycle.

### NADA Average Private Dealership Earnings Y/Y Growth Rate

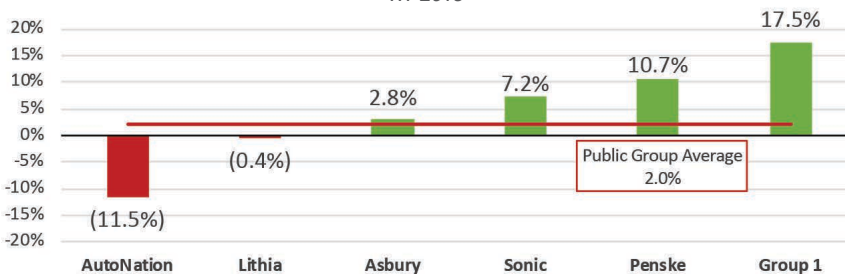


Source: NADA

As for the public companies, average profits rebounded in Q2 2018 following Q1's 2.3% YoY decline. So far in 2018, public company profits are up 2% compared to the first half of 2017. But there is a wide range of performance with profits at Group 1 up 17.5%, helped by its “value line” used car strategy, while AutoNation is down 11.5% compared to the first half of 2017.

### Public Company Y/Y Operating Earnings Growth

H1 2018

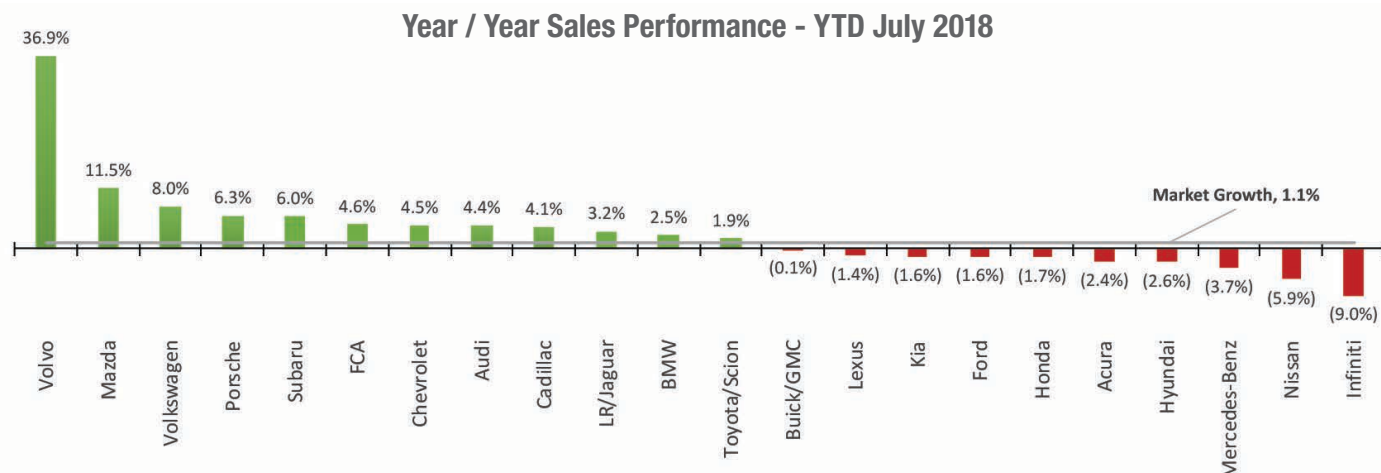


Source: SEC Filings

## Sales Growth for Individual Franchises

The following chart sets forth the change in new unit sales at the major franchises so far in 2018. Note, this data reflects changes in total sales per franchise, so it includes fleet sales that cloud the results at the retail level. Despite their jump in fleet sales, Hyundai and Nissan

have suffered so far in 2018. Jaguar-Land Rover, which posted big sales gains for the past several years has cooled off, while past poor performers including Volvo, VW and Mazda are seeing nice increases as they take advantage of new CUV product introductions. Ford is struggling a bit while GM and FCA are showing nice gains.

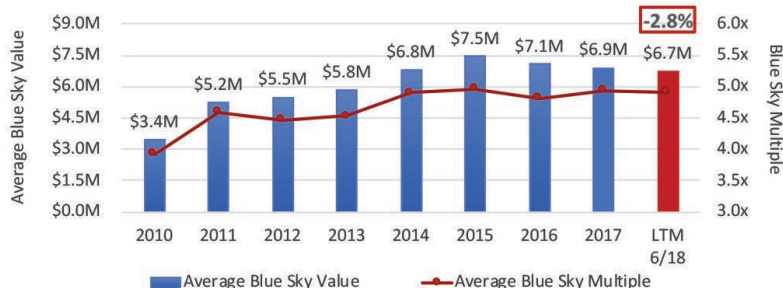


Source: Automotive News

## Dealership Values Are Declining, But Remain Strong

The average blue sky multiple for all franchises on an unweighted basis was 4.91x over the last twelve months according to our estimates, down a tiny drop from 4.93x last quarter. Profits per dealership over the last twelve months fell 2.3% compared to full year 2017. Applying the 4.91x blue sky multiple to the average dealership pre-tax profit of \$1.36M over the last twelve months generates an average blue sky value of \$6.7M, down 2.8% from year end 2017.

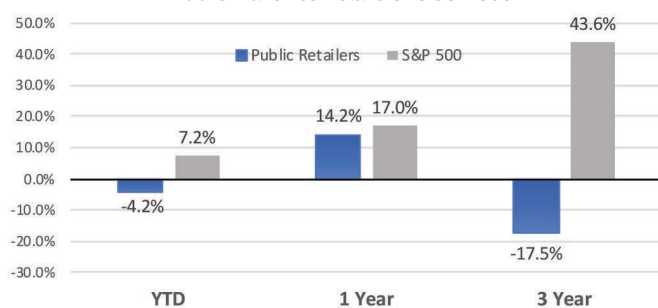
### Estimated Average Blue Sky Value



The stock market continues to be unexcited about the public retailers. The table set forth below shows that the average stock price for the public retailers has underperformed the S&P 500 Index on a year-to-date basis, over the past twelve months, and particularly over the past three years. Investors are concerned about declining profits in the short term, and the potential long-term disruptors that are now in the news almost daily. Many of these investors have moved to other industries, or prefer to invest in companies like CarMax or Carvana, an online used car retailer that has almost double the market capitalization of AutoNation. And notice that Penske Auto Group has now surpassed the market capitalization of AutoNation which had held the crown of the most valuable franchises auto retailer since 1996. Investors appear to be increasingly attracted to business models that show less reliance on new vehicle retailing which they expect will decline over the next few years.

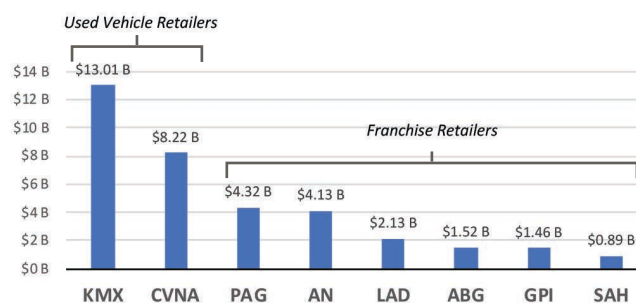
### Cumulative Stock Price Returns

Public Franchise Retailers vs S&P 500



Source: Yahoo! Finance; Data through 8/3/2018

### Public Retailer Market Capitalization



Source: Yahoo! Finance; Data through 8/14/2018

## Debates About Autonomous Vehicles, Ride Sharing, and Electrification Continues

A study by the consulting firm McKinsey estimated that \$100B has been invested in autonomous vehicle technology over the past decade, with 70% of it in the past three years. For companies like Uber, autonomous vehicles may provide a lifeline to profitability. For other companies, like franchise auto retailers, they are serious threats. Numerous industry experts have predicted that the best days of auto retail are behind us and many retailers will end up closing their doors. It remains to be seen how significant these threats will be, but investors have noticed and we believe they are beginning to avoid disruptees, like franchise auto retailers and traditional OEMs, and place their money on companies who may be the disruptors.

To us, it seems likely that these threats will impact auto retailers, but not for at least five to ten years. And even then, the impact will not be shared equally by all franchises, or in all markets. For instance, if the combination of ride sharing and autonomous technology will save money on transportation, then it seems likely that those who are most cost conscious will gravitate towards it. So sales of lower priced cars could suffer first. Trucks may be largely unaffected since many people use their trucks for their offices or for towing. Franchises that are heavy in trucks may feel little impact. Urban areas are a better fit for autonomous vehicles than suburban or rural areas, where wait times may be too long and distances too great for consumers to find them practical.

## The Leading Advisor to Buyers and Sellers of Higher Value Dealerships



### ABOUT HAIG PARTNERS

Haig Partners provides expert advice and comprehensive services to auto dealers interested in selling their businesses or buying new ones. We have been involved in 170 transactions for 290 dealerships totaling more than \$4.0 billion in value. With experience from AutoNation, Asbury, Bank of America, and Crowe, as well as prominent investment banks, Haig Partners is the leading full-service firm in our industry. In the past four years, Haig Partners has helped its clients to sell their businesses for over \$1.3 billion over the last four years, excluding the value of new vehicles.

Please visit our website at [www.haigpartners.com](http://www.haigpartners.com) for more information. We always enjoy hearing from dealers who are interested in buying or selling dealerships, or discussing the current state of the market.

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# BUY SELL TRENDS AND EVENTS

## Buyers Are Still Buying

Some might wonder why this should be called a “trend,” but we have been encouraged by the confidence we have seen from buyers in this market in which profits are downshifting slightly. Many dealers are not waiting on the sidelines waiting for prices to come down. They would rather invest their surplus capital now rather than leave it in the bank earning anemic returns. Even if profits decline over the next few years, these buyers are calculating that buying the right store in the right market is the smart thing to do today.

## Lenders Are Still Lending

We regularly speak with commercial lenders and all of them have indicated they are eager to loan more capital to dealers to help them finance acquisitions. None of them appear to be projecting a major decline in profits at dealerships, either due to a recession, changes in consumer behavior, or threats from technology. Some large banks are now promoting syndicated loan facilities that make it much easier for mid-to-large dealer groups to grow through acquisitions.

## A Get Big or Get Out Mentality Is Growing

A growing number of dealers believe that larger groups will thrive in the future while smaller dealers will suffer. Some of this is defensive thinking, that shrinking margins need to be offset by lower costs that can come from larger scale. And some dealers believe that scale will bring them advantages so that they can go on the offensive and take share from smaller dealers by offering more selection and convenience. CarMax, for instance, can market that it has many thousands of used vehicles in stock available for customers to purchase and finance through its website. A local dealer may just have 50 used units in stock with no ability for consumers to transact through his website. As consumers increasingly use their phones and computers for auto shopping, it seems likely that they will find their way to larger dealers. We also believe that larger dealers will be better positioned to attract and retain talent.

GET BIG  
or  
GET OUT

## “Mergers” Are Becoming More Popular

As some dealers adopt the Get Big Or Get Out mentality, they are changing their approach to acquisitions. A typical buy-sell transaction includes a buyer purchasing 100% of the stock or the assets of a seller. But we are now seeing a trend towards transactions where a seller sells the large majority of his company but retains some ownership in the dealership going forward, a “merger.” We say “merger” because in our minds they are still a form of acquisition (buy-sell) as the seller is no longer going to control the company, although he will have shareholder rights and may continue to operate the dealerships he is selling. Typically, the seller negotiates the rights to sell his remaining stake to the buyer in three to five years.

There are several major reasons why we see mergers as a trend that is likely to grow in our industry.

- **Mergers Allow Buyers to Grow More Quickly.** By spreading their capital across a larger number of dealerships than if they were paying all cash, buyers can acquire more stores. By building a larger enterprise at a faster rate, buyers believe they can lower their overhead costs and compete more effectively against smaller dealers.



## BUY SELL TRENDS AND EVENTS

- **Increased Security for Buyers.** If sellers retain some equity in the businesses they are selling, they will be more likely to care about how they perform in the future. For instance, they will do their best to retain their good people. By keeping some skin in the game, they make buyers feel more comfortable about buying their dealerships.
- **OEMs May Prefer Mergers.** Most OEMs we know are worried about dealership groups that try to grow too quickly. Toyota, for instance, likes new owners to limit their purchases of Toyota stores to just one per year. But if an OEM knows a seller is going to remain involved in his dealership, and may even remain on the dealer agreement, then the OEM is more likely to approve a merger transaction than a 100% acquisition.
- **Some Groups Have Grown Too Large to Acquire Easily.** We have represented a good number of the Top 150 groups in the US. It has been our experience that as the size of the group increases, the number of potential buyers decreases. If a large group decides it wants to exit, it will find more willing “buyers” if it is willing to accept a “merger.”

Family offices and private equity firms commonly employ this structure to improve returns and reduce risk. Now we are also seeing mergers proposed by privately owned dealership groups.

## More Sellers Are Coming to Market

The number of dealers willing to sell their businesses is at a high level today compared with what we have seen in the past. The increase in the number of stores for sale is likely due to several reasons: an aging dealer body, the beginning of what may be a decline in dealership values, greater recognition that economies of scale (digital marketing, facilities, talent development and retention, etc.) are required to compete, and the possibility of a permanent change in the way that consumers pay for their transportation.

## Buyers Are Pickier

Buyers are telling us they are more selective given where we are in the auto cycle. They want stores that are a tight fit with their acquisition strategy in terms of location, franchise, and operating performance. Dealerships that have challenges, such as facility issues, unions, or incoming add-points, will need to be priced lower than before to get the attention of buyers. Weaker brands may also struggle to get attention. And since profits may continue to trend down, time may work against the interest of sellers. Buyers will scoff at overpriced dealerships and sellers may suffer a long marketing period may result in a lower price than if they had priced their dealership at current values.

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# FRANCHISE VALUATION RANGES

We have been involved in the purchase and sale of 290 dealerships in our careers dating back to 1996. In the past four years, Haig Partners has been involved in representing buyers or sellers of Acura, Alfa Romeo, Aston Martin, Audi, Bentley, BMW, Buick-GMC, Cadillac, Chevrolet, Chrysler-Jeep-Dodge-Ram, Ferrari, Fiat, Ford, Honda, Hyundai, Infiniti, Jaguar/Land Rover, Kia, Lamborghini, Lexus, Lincoln, Maserati, Mazda, McLaren, Mercedes-Benz, MINI, Nissan, Porsche, Subaru, Toyota and VW dealerships. Each quarter we contact many leading dealer groups as well as accountants, bankers and lawyers who practice in auto retail. The information that we gain from these conversations and our own transactions form the basis for the following evaluations.

## Dealership Valuation Methods

Although there are various ways to value dealerships, we will refer to the traditional method of combining blue sky (calculated as a multiple of adjusted pre-tax profits), plus the value of other assets acquired. Pre-tax income should exclude non-recurring income or expenses and properly reflect the market value of any real estate owned by the seller and leased to the dealership.

The blue sky multiple ranges that we set forth in this report reflect our expectations what buyers in *competitive situations* will pay for the goodwill of dealerships and we note any upward or downward changes from Q4 2017. We remind the reader that each dealership transaction is unique and dealerships may trade above or below the ranges we describe in this report. Dealerships that are underperforming or are in highly desirable markets may have higher values. Conversely, dealerships that are in less desirable markets, are overperforming or that have significant real estate issues may bring lower multiples.

## Luxury Franchise Blue Sky Multiples



**Porsche.** Porsche has had a strong start with 6.3% growth in the first seven months of 2018. It beat its all-time record for January to June sales and new car margins remain the envy of almost every other franchise. Porsche sales have been bullet proof in recent years and it understands the value in producing one car less than the market wants. Porsche stores rarely trade hands and buyers are numerous, particularly in metro areas. Same multiple range: 7.5x-9.0x.



Mercedes-Benz

**Mercedes-Benz.** M-B was down 0.3% in 2017, and is down another 3.7% so far in 2018 due to a 19.9% decline in July sales caused by inventory shortfalls and a mainframe outage. While M-B is still among the most desirable franchises, dealers are telling us that the franchise is in for a tough year. They expect the franchise to recover however, so buyers are still contacting us seeking these stores. We wish we had more to sell! Same multiple range: 7.0x-8.0x.



**Lexus.** After a rough 2017 with a decline of 7.9%, Lexus has fallen another 1.4% YoY. July was not particularly favorable for Lexus with a 12.1% decline to add to the fifth straight month of sales declines. The RX continues to perform well, but has not been able to compensate for the dramatic declines in sedans. Dealers remain supportive and still love the franchise. We were involved in the sale of four Lexus stores recently and demand was very high. Same multiple range: 7.0x-8.0x.



**BMW.** After a 2.4% decline in 2017, BMW is up 2.5% so far in 2018 and is the second highest volume luxury brand in 2018. There is a good chance that BMW will regain the sales crown in 2018. Inventories are tight with days supply being the lowest in the industry. That means healthy margins for dealers. Key redesigns of vehicles have helped recently and the redesigned X5 and launches of the new X2 and X7 CUVs should fuel further growth in sales and profits. One executive at a Top 20 dealer group told us the incoming product is excellent and he is more excited about BMW than any other franchise they own. We are also hearing fewer complaints about BMW putting pressure on dealers to punch new cars to achieve monthly sales targets (only to make them harder to achieve the next month). BMW is getting its mojo back! Higher multiple range: 7.0x-8.0x.



Audi

**Audi.** Audi continues to grow faster than the market with sales up an impressive 7.8% in 2017 and 4.4% so far in 2018. But dealer profits are much lower than at other premium luxury brands. Dealers have told us about shouting matches with Audi sales reps, upset that they have to sell new units at many thousands below invoice in order to hit their stair step targets and earn incentive payments – which still net them lower profits than at their Mercedes, BMW or Lexus stores. While consumers love the product, dealers tell us they are frustrated that the factory talks about, but does not correct, the issues with low dealership profits. Lower bottom value range: 6.0x-7.5x.



**Jaguar-Land Rover.** JLR sales so far in 2018 are up 3.2%. This is the slowest rate of growth we have seen in many years from JLR, and it concerns us given the large number of add points and facility expansions that are going on around the US. Dealers have been forecasting big sales increases at high gross profits per unit to justify spending all the capital on JLR's very expensive facility requirements. If sales slow, then dealers may begin cutting margins which could lead to big drops in profits for dealers. For combined JLR stores where no add point is coming, same multiple range: 6.0x-7.0x.



**Cadillac/Acura/Infiniti.** Cadillac sales were down 8% in 2017, but are up an estimated 4.1% in 2018 thanks to the 28.2% YoY sales gains of the Escalade. This franchise badly needs a broader product mix. With its sedans being uncompetitive despite billions of dollars of investment, GM needs to give Cadillac more trucks. For instance, we have to think there is a market for a super-premium pick-up truck. Or more high powered SUVs. Acura underperformed and was down 4.2% in 2017 and 2.4% year to date. Acura also needs new CUV models in order to achieve sales growth and dealers are reporting the new RDX is jumpstarting sales. Infiniti had an impressive 10.9% gain in 2017, but sales are down 9.0% so far this year. A bright spot for the brand is the redesigned QX50 crossover. Same multiple range for this group: 3.0x-4.0x.



**Volvo.** After a surprising 1.5% decline in 2017, Volvo is up an impressive 36.9% in the first seven months of 2018. The new XC60 is driving much of Volvo's momentum. A new compact CUV (XC40) and redesigned S60 should fuel further growth and the company has launched a new subscription service with its CUV. It will take time for fixed operations to recover as units in operation fell to a low level. Nevertheless, this franchise demonstrates that fading brands can be rejuvenated with fresh product. Volvo still has many loyal customers and should attract even more eco-conscious buyers as it transitions to an all hybrid and electric fleet over the next 5-10 years. Higher top value range: \$1,500,000 - \$2,500,000.

## Mid-Line Import Franchise Blue Sky Multiples



**Toyota.** Toyota beat the market in 2017 with 0.5% sales growth and is up another 1.9% so far in 2018. Toyota reaffirmed its commitment to be a full-line OEM so it should gain from Ford's abandonment of the sedan segment. We are hearing margins are up at many Toyota stores thanks to good products and tighter production. Toyota has more new products coming than any OEM over the next few years according to Bank of America's Car Wars Report, which should help retail profits. Dealers continue to love this franchise thanks to high profits per store and a dealer-friendly OEM. In a Summer 2017 NADA dealer survey, Toyota was ranked first, tied with Honda and Subaru, in terms of their optimism for the future. Like Mercedes, we get many calls from dealers looking to buy this franchise. Same multiple range: 6.0x-7.0x.



**Honda.** Honda sales grew 0.7% in 2017 but are down 1.7% so far in 2018. Sales of core models (Accord, Civic, HR-V and CR-V) are down so far this year, while the redesigned Pilot has been a standout for Honda with a 38.5% increase this year. Although new vehicle margins are weak at many stores, loyal customers and a balanced business model of strong variable and fixed operations continue to attract buyer interest. Reasonable facility expectations are another strength of the Honda franchise. In a Summer 2017 NADA dealer survey, Honda was ranked first, tied with Toyota and Subaru, in terms of their optimism for the future of the franchise. In an age of increasing complexity in auto retail, Honda dealerships provide dealers with steady, predictable profits. Same multiple range: 6.0x-7.0x.



**Subaru.** Subaru's sales growth continues, up 5.3% in 2017 and 6.0% growth in the first seven months of 2018. Sales in Q2 slowed significantly, however, so it's possible that Subaru may not be able to continue its impressive growth streak forever. The new Ascent 3-row SUV will help attract sales in one of the hottest segments. In a Summer 2017 NADA dealer survey, Subaru was ranked first, tied with Honda and Toyota, in terms of their optimism for the future of the franchise. Same multiple range: 5.0x-6.0x (with pricing higher in Snow-Belt states).



**Kia.** Sales were down 8.9% in 2017, but are off only 1.6% so far in 2018. Older models such as the Optima, Soul and Sedona are hurting sales while exciting new models such as the Stinger and Niro did well. A large CUV, the Telluride, is coming in 2019 and should help. In the right market these dealerships can make \$1M-\$2M per location, although we also see them struggle in over-dealtered markets. There are many Kia stores on the market today. Lower multiple range: 3.0x-4.0x.



**Hyundai.** Sales were down 13.4% in 2017, the worst performance among the major brands we track. Sales were down another 2.6% so far in 2018. Hyundai's sales mix is 55.6% cars when the rest of the market is 68.3% trucks and CUVs. We are told a large CUV and light truck are in the works. The previous plan to sell Genesis vehicles exclusively through standalone locations is dead. For value buyers, this could be a smart time to buy Hyundai franchises as its future seems brighter than its present. Same multiple range: 3.0x-4.0x.



**Nissan.** Sales were up 1.0% in 2017 thanks to heavy fleet sales, but have declined 5.9% in the first seven months of 2018, including a massive 29.1% drop in April, an “extremely challenging month,” according to Nissan. Dealers tell us the stair step incentive payments have been slashed although sales expectations remain unreasonable at many stores. One dealer told us he is going to focus on used car sales for the next year and not chase his stair-step targets. He expects his new car sales to drop over the year which will reset his stair step programs for 2019 to more reasonable levels. Many excellent dealers we know are “done” with the franchise although others view it as a leading brand that will eventually sort out its sales system become a good investment. Same multiple range: 3.0x-4.0x



**Mazda.** After declining 2.8% in 2017, Mazda is up 11.5% in the first seven months of 2018 thanks to an impressive 36.1% sales increase for the redesigned CX-5. Mazda has been underweighted in CUVs and has no light trucks at the moment, which has cost them sales in this environment of cheap gas. Its new partnership with Toyota should increase supply of CUVs and boost profits. A new CUV model is expected in late 2019. Same multiple range: 3.0x-4.0x.



**VW.** The positive momentum at VW continues with sales up 5.2% in 2017 and another 8.0% so far in 2018. The Atlas and new Tiguan are huge winners, but cars are down a whopping 35.9% this year. Buyers are more curious about this franchise and some locations perform at a high level. Profits in 2016 and 2017 are muddled by payments from VW to dealers so the franchises are not likely to trade on a multiple of pre-tax earnings. Higher average top value range: \$1,000,000 - \$3,000,000.

## Domestic Franchise Blue Sky Multiples

*(Note: The multiples paid for domestic franchises will likely be higher in markets like Texas where trucks sell well and lower in markets like California where imports dominate.)*



**Ford.** In the first seven months of 2018 Ford is down 1.6%. We are still unconvinced about Ford’s decision to exit the car business which represents more than 20% of Ford’s total sales year to date (about 14 units a month for the average dealer). And fixed operations may suffer if the number of units in operation falls. With the new Bronco and Ranger coming, dealers may soon forget about the era of Fiestas and Fusions. We have been involved in the purchase or sale of eight Ford dealerships in recent years. Lower multiple range: 4.0x-5.0x.



**Chevrolet.** Chevy is up 4.5% so far in 2018 on the strength of retail sales. Sales of all of Chevrolet’s trucks/SUVs/ CUVs are positive, while cars are down 18.7% so far this year. The new Silverado/Tahoe models are coming soon. Some dealers tell us they are missing their SFE targets so far in the first half of 2018, which were layups in an era of rising sales. The appetite for this franchises has dwindled due to this uncertainty. GM will need to evolve this program in an era of flat to declining sales. Chevy may have become the best positioned domestic brand, replacing Ford especially if it can capture some of the sedan customers who may have nothing to buy from Ford. Refreshed Malibus, Cruzes and Sparks will be waiting for them. Same multiple range: 4.0x-5.0x.



**Buick-GMC.** In 2017, sales were up 0.5%, but are flat so far in 2018. Buick will likely see incremental growth as it launches the Avenir luxury sub-brand. Like Chevrolet, new large pickups and SUVs are coming in MY 2019 and 2020, respectively, and should help these brands do well. And like Chevrolet, dealers are having a harder time meeting their SFE targets with flat to declining sales. We are told that GMC will become further differentiated from Chevy and incorporate numerous advancements such as a carbon fiber bed, which could help it take share from other truck makers. Sales per store are lower than at other franchises, but grosses per new unit sold can be much higher than at other brands. B-GMW is a bit of a sleeper franchise that can produce a very nice return on investment for buyers. Same multiple range: 3.75x-4.75x.



**FCA (Chrysler-Jeep-Dodge-Ram-Fiat).** Sales are up 4.6% so far in 2018. Some dealers have been wary of this franchise as they are concerned about below average quality, and a relatively weak corporate balance sheet. But margins are higher than many other mid-line brands and fixed ops are strong (thanks to low vehicle quality). The new Wrangler is selling strongly and received very favorable reviews. FCA was the first to pull out of the small car business and we expect that will work out well for them in the near term. But, like Ford, if gas prices and/or fuel efficiency standards rise, FCA will have made a bad bet. Same multiple range: 3.25-4.25x.



## SUMMARY



The good times continue for auto dealers, although the party is beginning to fade a bit. Dealership profits are trending down slightly as sales stall and costs rise. Dealership values remain high compared to historical levels, but are declining slightly along with falling profits and reduced demand for a handful of franchises. There was a massive increase in the number of dealerships sold in Q2 2018, up 87% from Q2 2017, that we think is a result of more franchises coming up for sale, and increased demand from buyers due to the change in the tax code that has increased after-tax cash flows for all dealership owners. We expect the buy-sell market will remain robust for the remainder of 2018 as some dealers are choosing to Get Big, while other dealers are choosing to Get Out.

Having been involved in over 170 transactions for more than 290 dealerships, no other firm has a better understanding of the perspectives of both buyers and sellers of dealerships across the US, and we use this perspective to negotiate highly desirable outcomes for our clients.

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<b>Sovereign Motor Cars Ltd.</b>    of Brooklyn, NY Acquired by <b>Carmichan Holdings</b>  New York <small>Transaction closed at previous firm.</small>	 <b>TOYOTA</b>  Fort Myers Toyota Acquired by <b>AutoNation</b>  Florida <small>Transaction closed at previous firm.</small>	   Panama City John Eagle Dealerships Acquired by <b>GROUP 1</b> AUTOMOTIVE®  Florida <small>Transaction closed at previous firm.</small>	  Acquired by   California <small>Transaction closed at previous firm.</small>	 <b>TOYOTA</b>  Toyota of Lewisville Acquired by <b>RLJ mclarty landers</b> automotive  Texas <small>Transaction closed at previous firm.</small>	     Acquired by <b>GROUP 1</b> AUTOMOTIVE®  California <small>Transaction closed at previous firm.</small>			
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- **Dealer Summit with Bass Sox Mercer, Crowe, and SunTrust:** Dallas TX, November 15, 2018
- **AutoTeam America Buy-Sell Summit before NADA:** San Francisco, CA, January 24, 2019
- **NADA Distinguished Speaker Series with Dale Pollak at NADA Convention:**  
San Francisco, CA, January 25, 2019

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