

# THE HAIG REPORT®

TRENDS IN AUTO RETAIL AND THEIR IMPACT ON DEALERSHIP VALUES

## THIRD QUARTER – 2017

- The number of rooftops that sold in Q3 declined 22% from Q3 2016, a surprising result given all the M&A activity.
- The number of rooftops sold through September 2017 is down 18% from the same period in 2016.
- Acquisition spending in the US by the public companies through Q3 2017 reached \$935M, an increase of 62% from the first three quarters of 2016.
- Private dealership values fell 3.2% due to declining earnings.
- Haig Partners' blue sky multiples are mostly unchanged.
- Significant deal activity implies strong market conditions for future quarters.



# OVERVIEW

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The sun continues to shine on dealers in the US, although they are sweating a bit more these days to try to maintain their high profits. The economy is in high gear with low unemployment, strong GDP growth and high consumer confidence. Although the OEMs are producing lots of attractive products, they are having to offer consumers higher incentives to sell them, a sign that demand may be saturated. Dealers are facing slowing sales, declining vehicle margins and rising costs, but overall, conditions remain healthy for dealers. And despite much recent discussion, we have not seen any impact to the value of their dealerships from the various new threats on the horizon that we will discuss in greater detail later in this report.

## The Buy-Sell Market Remains Active

The number of dealerships that sold in the first three quarters of 2017 is down 18% compared to the same period in 2016 according to the [Banks Report](#) and our data. Expectations were high for Q3 but results were surprisingly low, down 22% compared to Q3 2016 when 103 stores changed hands. In our conversations with people involved in the purchase and sale of dealerships, we are aware of a number of mid-to-large sized transactions that fell apart for various reasons. We suffered our own losses as well! It is worth noting, however, that the 80 stores that traded hands in Q3 is above the quarterly average for 2013-2016 so demand for dealerships remains healthy.

Group transactions made up 24.5% of total transactions in the first three quarters of 2017 compared to 28.2% in the first three quarters of 2016. The average group size that sold increased slightly from 3.1 stores to 3.2 stores. Stores in group transactions represented 51% of all stores sold, down from 55% in the first three quarters of 2016. Domestic stores made up 50% of volume so far in 2017, up from 46% in the first three quarters of 2016. Buyers are attracted to these dealerships due to their strength in trucks and SUVs. The share of luxury stores that sold declined, making up 14% of volume in the first three quarters of 2017 compared to 17% in the first three quarters of 2016. Import stores were unchanged at 37% of volume in the first three quarters of both 2017 and 2016.

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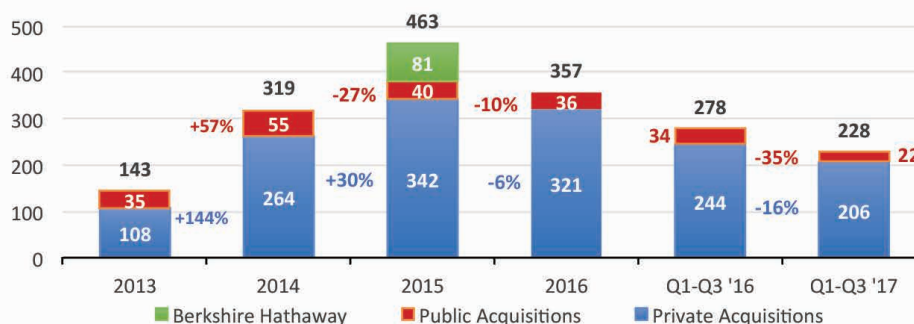
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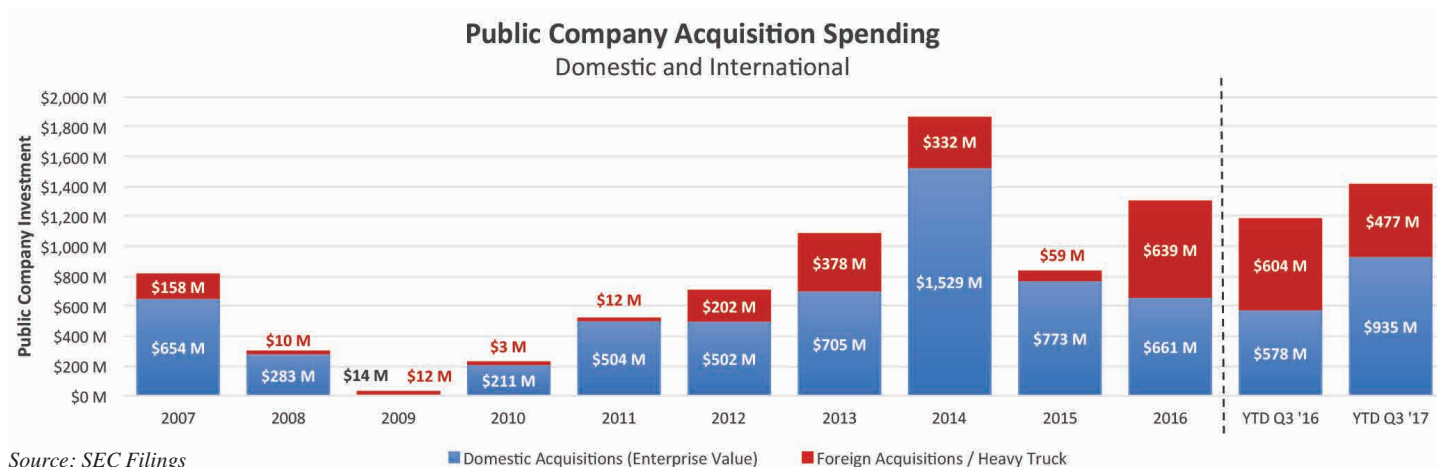
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## US Dealerships Bought/Sold



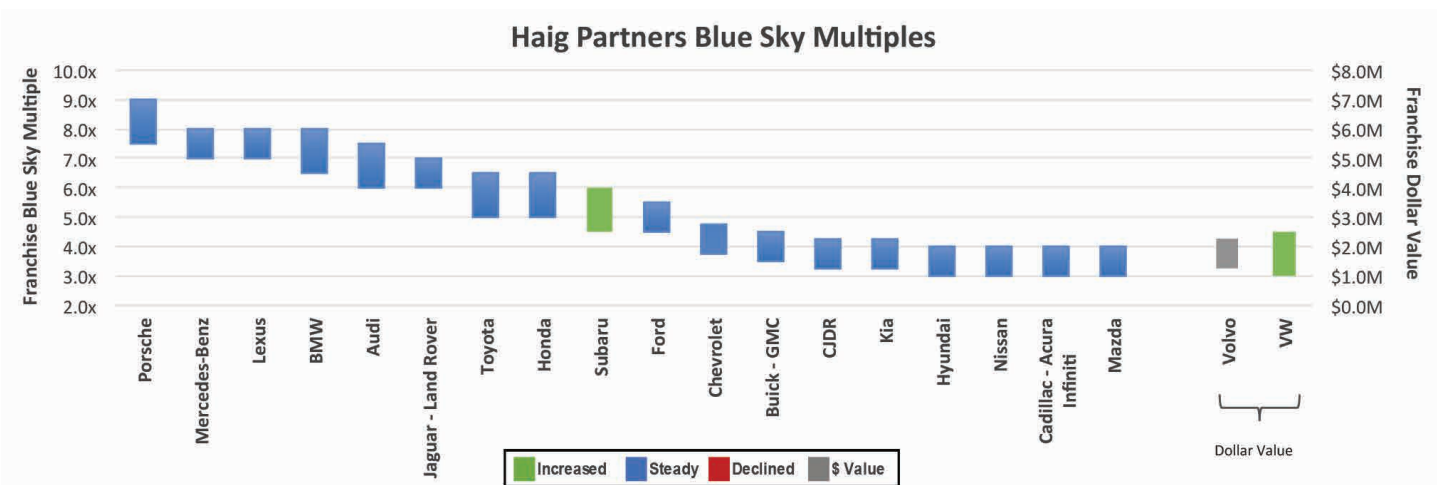
After a slow start, 2017 will be a very strong year in M&A for the public retailers thanks to a number of large transactions in Q2 and Q3. Five of the six public companies have now spent \$935M on US acquisitions this year, a 62% increase from the first three quarters of 2016. Even if the publics don't spend another dollar, 2017 will be the highest level of spending on US auto acquisitions over the past decade except for 2014. Despite all the noise regarding the potential negative impact on auto dealerships from ride sharing, electrification, autonomous vehicles and changes to the franchise system, the "smart money" is still buying dealerships.



There is more “supply” of dealerships available for purchase than at any time we can recall. Perhaps this is due to an aging dealer body, or a realization that dealerships have peaked in terms of value so dealers who want out in the next few years are looking to sell now before values fall further. Sellers are far from desperate, however. They are not selling their dealerships cheaply. Buyers are also plentiful, but they are cautious given declining dealership profits. The result is an active market with dealerships trading hands for slightly less than they sold for in prior years due to slightly lower earnings, though many deals are failing as buyers and sellers are unable to agree on price.

## Blue Sky Multiples Are Mostly Unchanged

Despite the slight decline in dealer profits, we have not seen any meaningful movement in blue sky multiples since we released our Year End 2016 Haig Report. Dealerships in attractive markets with no facility issues continue to bring strong prices, but dealerships that have significant challenges are attracting little interest from buyers since they have many acquisition options. 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. Some OEMs like Toyota/Lexus, Mercedes-Benz, and BMW also offer large amounts of credit to buyers of their dealersships, which helps to boost the returns from buying their dealerships. 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.



# TRENDS IMPACTING AUTO RETAIL

## Overview

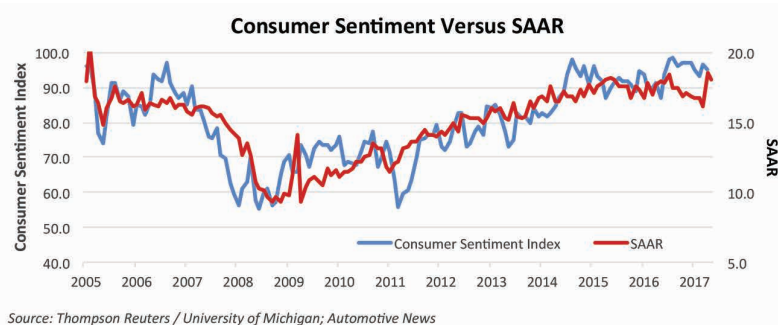
The dealers we have spoken with are still pretty happy, although they are frustrated with the influence of the OEMs in their daily operations. Dealers seem increasingly resigned to the fact that we are in a world of slowly declining profits and are pivoting to focus on used vehicles, F&I and fixed operations. And dealers are increasingly looking at their expenses, trying to reduce advertising, floor plan and compensation.

## Macroeconomic Indicators Are Mostly Positive

- **GDP Is Growing.** GDP grew at 3.1% in Q2 and the preliminary reading for Q3 was a healthy 3.0%, exceeding the 1.8% and 1.2% growth of the previous two quarters. GDP growth for 2017 is forecast at 2.3% and increasing to 2.5% in 2018 according to the Conference Board.
- **Employment and Household Income Are Increasing.** The US added over two million jobs in 2016 and is on pace to add another two million in 2017. The unemployment rate in July stood at 4.1%, the lowest rate since 2000, and was 2.0% for college graduates. Wages grew 2.7% in Q3, the second best growth rate since 2009. The employment picture does not get much better than this with plenty of jobs going unfilled.
- **Number of Miles Driven Is Increasing.** The total number of miles driven, which influences the vehicle replacement rate and is a key measure of demand for autos, increased 2.2% in 2016 compared to 2015 and another 1.5% in the first 7 months of 2017 according to the US Federal Highway Administration.
- **Gas Prices Remain Low.** The Department of Energy reported that the average price per gallon of fuel was \$2.49 at the end of October. Although gas prices are up 12.5% so far this year, they remain close to the lowest levels we have seen in years. Low gas prices allow consumers to use their vehicles more and afford higher car payments.
- **Consumer Sentiment is High.** We remain near record high levels of consumer sentiment. There is a strong correlation between auto sales and consumer sentiment. Consumers have a positive outlook and that is helping to keep new and used vehicle sales near record high levels.

For all the economic positives, there are a few indicators headed in the wrong direction and are giving some dealers concerns about the future:

- **Loan Terms Are Tighter.** Recent reports have indicated several banks have tightened standards for sub-prime borrowers by requiring higher down payments, raising rates, reducing 84 month loan availability and requiring higher credit scores. Edmunds recently reported the average down payment on a new vehicle loan increased 10% from last year. The average loan term and monthly payment were virtually unchanged.
- **Interest Rates Are Increasing.** The Fed has been increasing interest rates and they are likely to go higher. Current projections are for another 0.25% increase in the upcoming months and 0.5% more in 2018 as the economy continues to grow. Higher rates are beginning to eat into dealers' profits, particularly when vehicle inventories are inflated and many dealers have built expensive facilities in recent years that are financed with floating rate loans. Fortunately, the impact has been milder for consumers with the average 60 month new car loan rate increasing by 0.2%.

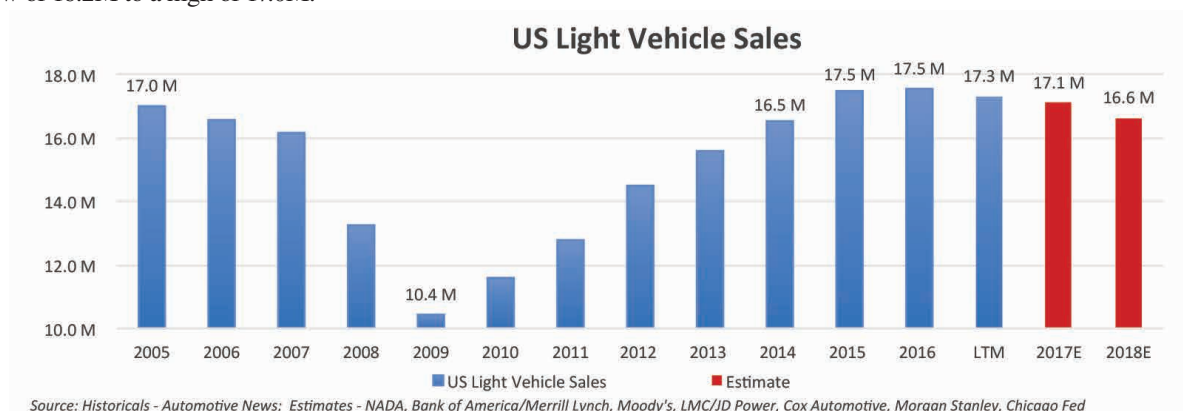


## TRENDS IMPACTING AUTO RETAIL

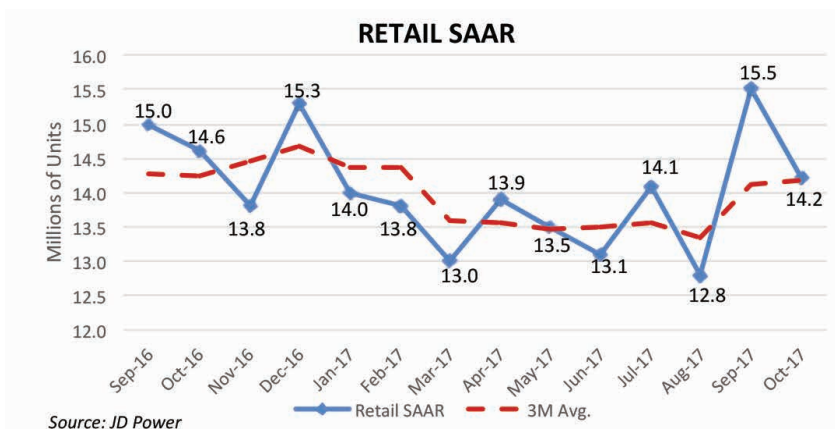
**Profits Are Declining at Most Dealerships.** Per NADA, profits for the average privately owned dealership fell 4.2% in the first 8 months of 2017 after falling 2.4% in 2016. Public company filings show adjusted operating income falling at four of the six publics through Q3, with the group down 1.7% overall.

## 2017 New Vehicle Sales Are Down Slightly But Still at Healthy Levels

After 2016's record high sales of 17.55M new units, 2017 looks like it is going to be another strong year for auto sales, likely coming in around 17.1M units, with most of the decline from 2016 coming from fleet sales. At this level, every OEM, supplier and dealer should be nicely profitable. The US economy shows no signs of a recession, but analysts still predict a decline in 2018 to somewhere in the 16.2M to 17.0M unit range. The 16.6M estimate for 2018 shown below is an average of six forecasts released over the last few months that range from a low of 16.2M to a high of 17.0M.



Note the data above is for total new vehicle sales, including fleet sales. According to Automotive Fleet, fleet sales are down 8.3% through October 2017 which would put retail sales almost flat with last year. Data from JD Power in the chart below confirms US Retail SAAR is less than 1% lower so far in 2017 compared to 2016, and the 3-month rolling average for number of new retail units sold is the same as in October of 2016. So dealers are still basically selling the same number of vehicles they did in 2016, but facing a different environment with margins and expenses.



## ABOUT HAIG PARTNERS

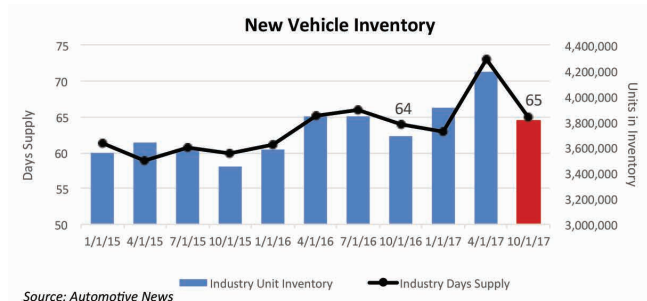
Haig Partners provides expert advice and comprehensive services to auto dealers interested in selling their businesses or buying new ones. We have been involved in 160 transaction for 270 dealerships totaling more than \$3.6 billion in value. With experience from AutoNation and Asbury, as well as prominent investment banks, Haig Partners is the leading full-service firm in our industry. In the past two years, Haig Partners has helped its clients to sell their businesses for approximately \$800 million, 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.

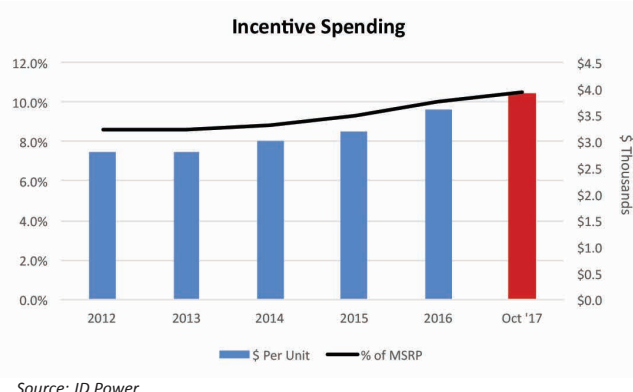
## TRENDS IMPACTING AUTO RETAIL

### Inventory Levels Are Back In Line

After growing to alarming levels earlier this year, inventories are back to a comfortable 65 days supply. The healthy sales we enjoyed in September and October may have been partly driven by consumers replacing vehicles destroyed by the two hurricanes that hit Texas and Florida. However, dealers in other parts of the country have also enjoyed strong sales recently. We are aware that Nissan dealers, in particular, still have a lot of 2017s to sell due to over production earlier in the year.

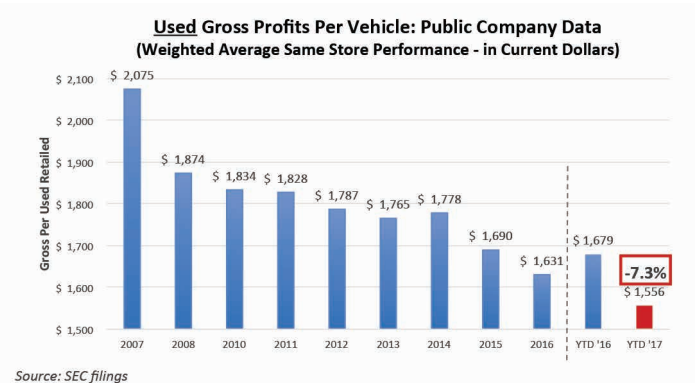
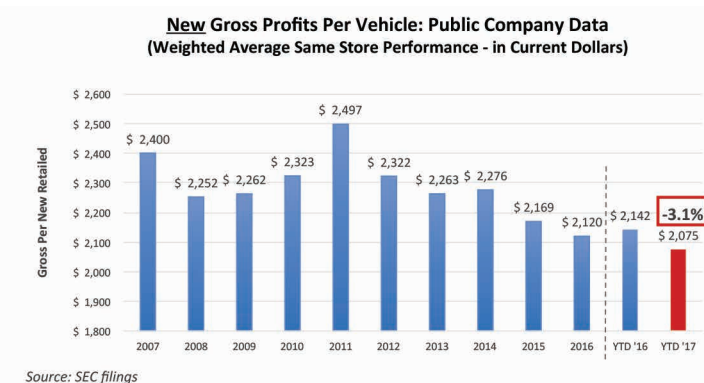


To stimulate further demand and help to offset rising inventories, the OEMs continue to crank up the discounts offered to dealers and customers. The following chart shows that incentives have been rising steadily and have reached the highest level in many years. While retailers complain that their margins are suffering, the OEMs are also enjoying lower profits per unit as they discount their products to attract customers.



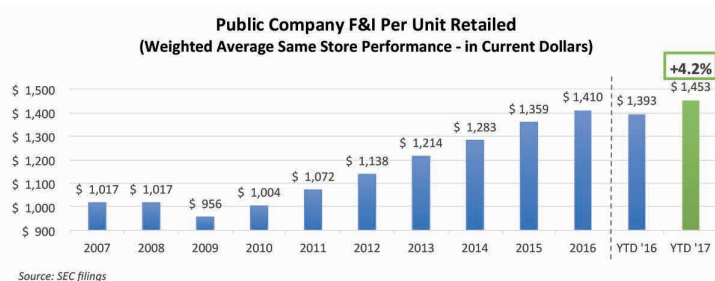
### Vehicle Grosses Continue to Decline

As a result of some of the factors discussed above, new vehicle profits continue their slide, down 3.1% in the first 9 months of 2017 for the public retailers. Leading retailers we speak to seem to be resigned that profits on new units will continue to be low until the OEMs reduce production. Used vehicle gross profits at the public retailers were down 7.3% so far in 2017, but this was largely driven by much lower margins at AutoNation that dragged down the average. Sonic again managed an increase in used unit profits.



### Finance & Insurance Departments Are Generating Record Profits

Gross profits from F&I continue to grow, which is helping to offset the decline in gross profits per new and used vehicle sold. In the first nine months of 2017, the public groups reported gross profit per vehicle retailed reached \$1,453, up 4.2%, or \$60 per vehicle, from the first nine months of 2016. All of the publics

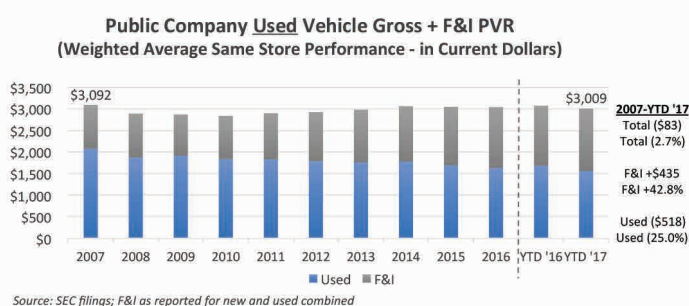


## TRENDS IMPACTING AUTO RETAIL

improved in this area, though the rate of improvement has slowed and is less than the declines in New and Used PVRs. A number of private dealers have disclosed they earn much higher profits than these figures, some over \$2,000 per vehicle retailed. And the public companies do not participate in reinsurance programs which are very lucrative for many private dealers.

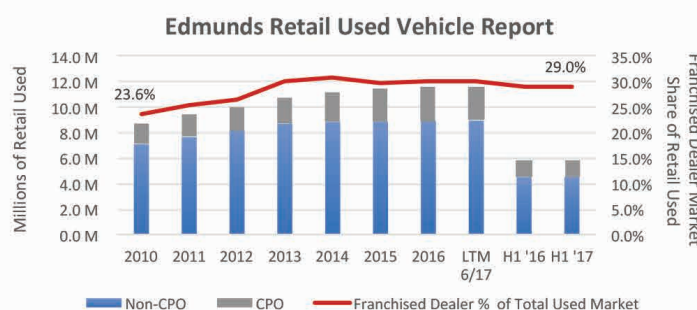
### Combined Front and Back: Profits per Vehicle Retailed Are Basically Flat

Although we hear many dealers lament the decline of vehicle margins, they have almost perfectly offset these losses with steady increases in F&I profits per vehicle retailed. The table below tracks this data back to 2009 and shows that on a combined basis total front and back end profits per vehicle retailed have remained largely flat, in dollar terms. Given the rise in new vehicle prices over this time, however, means that the profit margin as a percent of vehicle sales has fallen steadily.



### Used Vehicle Market Remains Healthy Despite Fears

A number of dealers have told us they are increasing their focus on their used vehicle departments as their new car sales and margins continue to soften. Franchised dealers account for just 30.1% of total used sales, up from 27.6% in 2010, but dealers' Used to New Ratio has actually declined from 0.90x in 2010 to 0.75x over the last 12 months, so there is significant upside potential. Dealers may have been more focused on their new vehicle departments and hitting their OEM sales targets. But now, for many non-luxury franchises, the profit per unit on used vehicles exceeds the profit per unit on new vehicles.



### Uncle!

For the past three years many dealers have been complaining loudly about declining margins and the increasing role the OEMs are playing in their businesses. They feel they are delivering commodity products at razor thin margins set by the market. While still frustrated at the trend, some leading dealers we have spoken with have begun to accept their fate. New cars have become commodities, almost loss leaders. These dealers are pivoting and working to develop higher profit streams from their other departments.

## Scale Is Becoming Increasingly Important as Technology Becomes an Ally and a Threat.

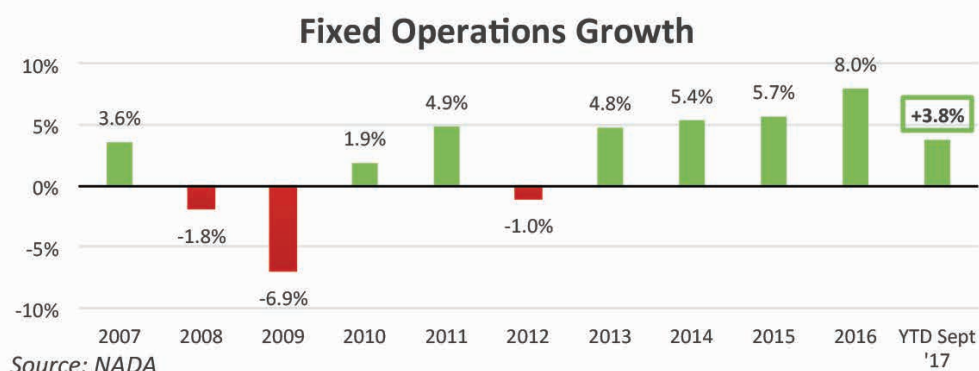
We regularly see many of our single point private dealers out-selling and out-earning dealerships owned by public companies. The strength of their entrepreneurial abilities is greater than the strengths of the brands, technology, systems and processes of larger retailers. But we wonder if this advantage is dissipating due to changes in technology and consumer trends. The most forward-thinking retailers we know are beginning to focus more of their efforts on delivering consumer friendly experiences that encourage their customers to come back with greater frequency and over a longer period of time. This long-term focus on retaining customers is part of the strategy of at least one dealer that we spoke to who wants to evolve his group from being a “dealer” to a “transportation provider.” He has cut his markup on financing to 1% and is instituting other consumer friendly practices. And he will begin offering his customers a subscription service where they pay one flat amount per month to drive a variety of vehicles that covers the depreciation, taxes, maintenance, etc. To hit the OEM sales targets and make a profit, he is developing software that will price his vehicles instead of relying on humans, just like the yield management software airlines and rental car companies use to maximize their profits. They fill every seat by varying prices according to supply and demand. The dealer is buying more dealerships as he believes larger groups will be able to use their scale to reduce costs and to deploy technology that will better provide consumers what they want and therefore take share from smaller retailers. Another dealer we know is avoiding greater investments in bricks and mortar, but is focused on pick-up and delivery of sales and service vehicles in order to please customers and extend his reach. He is focused on providing his customers with “frictionless commerce.” While their strategies differ, both retailers are evolving to create sustainable businesses that can overcome challenges like margin compression and new entrants.

Treating the customer nicely is not a new concept. At AutoNation in 1996, one marketing executive came up with idea of treating each customer as a “citizen” of AutoNation and provided “passports” to customers in the form of a loyalty card that could be used to get discounts at any AutoNation store across the country and at other consumer companies. The goal was to increase loyalty which would increase revenue and cut expenses. The concept was shelved for many years since there was no common brand across AutoNation dealerships and it later closed its used car megastores, but this vision may be coming to fruition soon as AutoNation is now offering consumers shopping experiences at its new car stores, used car stores, collision centers and sells its own brand of replacement parts. AutoNation has also spent heavily on digital advertising and a system to allow consumers to transact online, with virtually no interaction with live bodies. And AutoNation recently announced a partnership with Waymo to service its future autonomous vehicle fleet in the markets in which AutoNation operates. This may not prove to be a big money maker, but it is another indicator that scale matters more in the future than it has in the past and the vision that some people have of a few giant retailers providing transportation services to the masses may one day come true. We wonder if other retailers will begin to evolve to provide a more consumer friendly business model even if it means lower profits in the short term. If not, it’s possible the likes of Amazon will enter auto retail and take customers from traditional auto dealers the way it has taken customers from traditional retailers in other industries.

There is an old saying that goes, “Every morning in Africa a gazelle awakes and knows it must outrun the fastest lion or it will be killed. Every morning in Africa a lion awakes and knows it must run faster than the slowest gazelle or it will starve. It doesn’t matter whether you’re a lion or a gazelle, when the sun comes up, you had better be running.” Thanks to state laws and the franchise systems, auto dealers have enjoyed greater protections against competition than many other retailers. Technology may be eroding these protections in the future.

## Fixed Operations Driving Higher Profits

Private dealers reported fixed operations increased 3.8% so far in 2017 compared to the same period in 2016. Public retailers also did well, averaging 2.6% growth on a same-store basis in the first 9 months of 2017 compared to the same period in 2016. Seven years of rising sales have significantly increased the number of units in operation. Also, numerous recalls have boosted service departments. Higher profits from fixed operations may continue to support

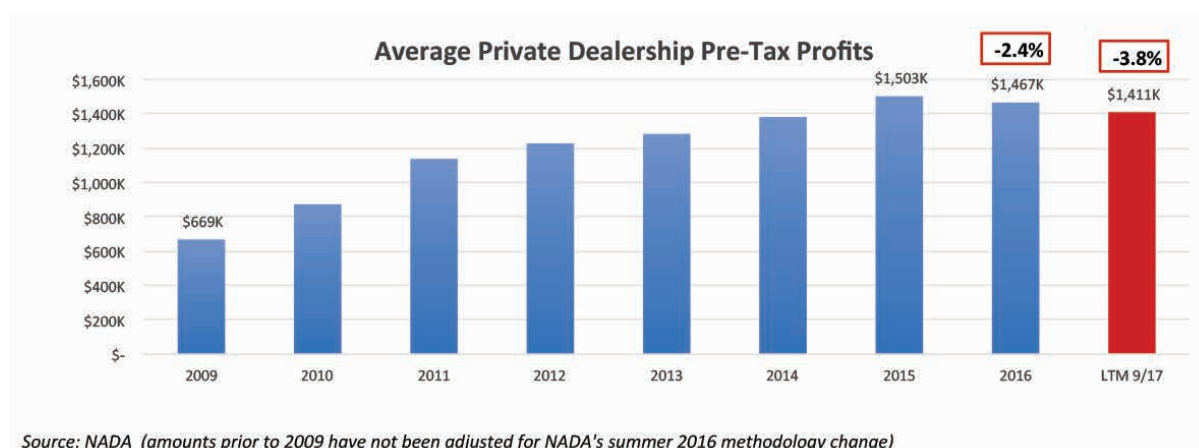


dealership profits even if vehicle sales and/or margins worsen, although it is worth noting that 2017's growth is the slowest we have seen in five years.

One dealer told us that he is trying to increase his service retention by ten points which he believes will increase his net-to-sales by one point. That is, he believes his net profit could increase from 3.0% to 4.0%, a 33% increase in profit. He admits such a jump will be very difficult due to leasing, long-term finance contracts, etc. But he has developed a long-term plan to focus on owners of vehicles that are four to ten years old and are in greatest need of repairs, parts and maintenance. He will likely need to develop new techniques of marketing to these consumers and may need different pricing strategies as well.

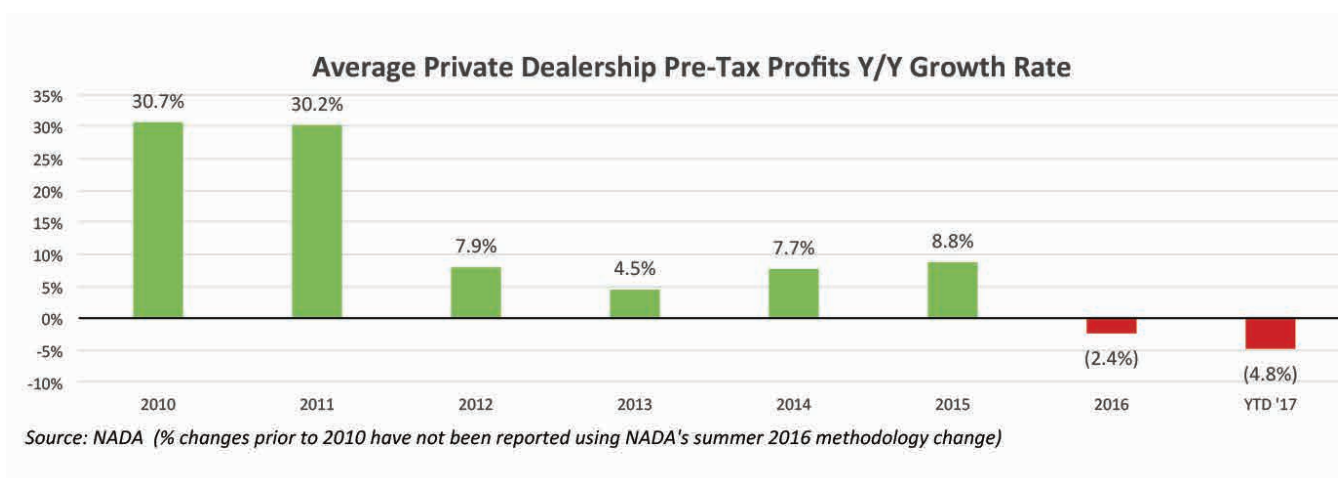
## Dealership Expenses Are Growing Faster Than Gross Profit

Rising costs appear to be the greatest threats to dealership profits. NADA data shows the average privately owned dealership during the first nine months of 2017 grew gross profit by 0.1% while the public companies grew their gross profit by 3.9%. However, the average private dealer saw expenses increase 3.2% and the public companies had an increase of 5.5% (per SEC filings, adjusted). Dealers are telling us they are seeing higher floorplan expenses, higher compensation expense, and well as higher rents from the many expensive facilities that have been built in recent years.

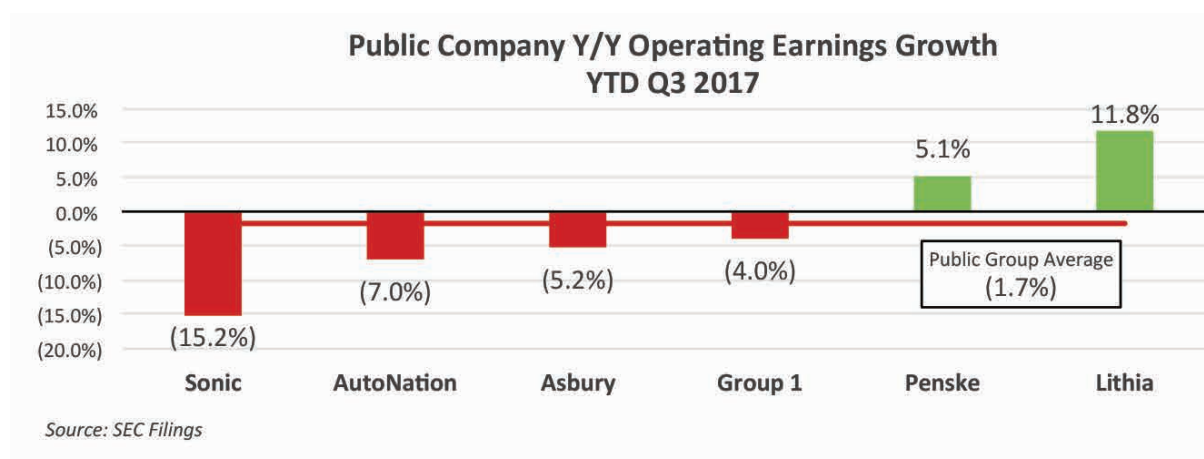


## Dealership Profits Drop Slightly

The net outcome of the trends listed above is that profits at privately owned dealerships declined 3.8% from full year 2016 to the last twelve-month period ending September 2017, according to NADA. The year-to-date decline is even greater, at 4.8%, which indicates the decline is accelerating. With average profit of over \$1.4M per store, we remain close to the highest ever level so dealers we speak with are still pretty happy.



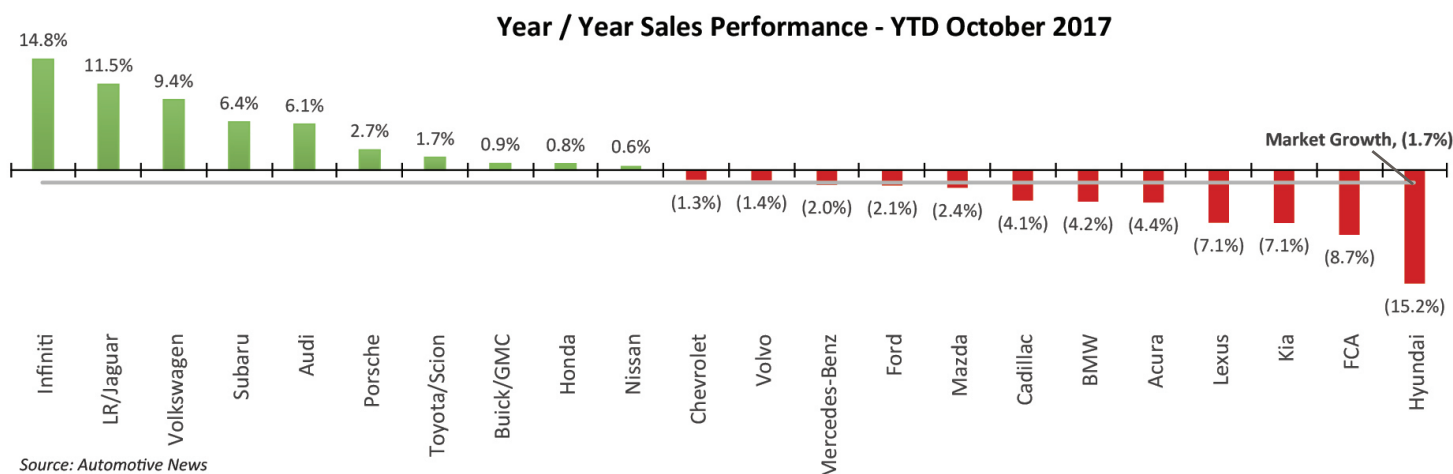
The table below shows the annual *change* in profits at privately owned dealerships since 2009. Like many dealers, we wonder what will happen to future profits at dealerships. Prior to the Great Recession, during the 2001 to 2007 period when new vehicle sales were essentially at a plateau, NADA data 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. It is possible we are now entering into a similar cycle. It appears that gains in F&I and Fixed Operations are slowing and may not be enough to offset lower vehicle margins and slowing sales. Alert dealers will focus on expense control and increasing efficiencies to maintain or even boost profits until conditions begin to improve again.



As for the public companies, average profits have fallen 1.7% so far in 2017. But there is a wide range of performance with profits at Lithia up 11.8%, in part due to its healthy acquisition pace, while Sonic is down 15.2%, which it attributes to heavy spending on its used car dealerships.

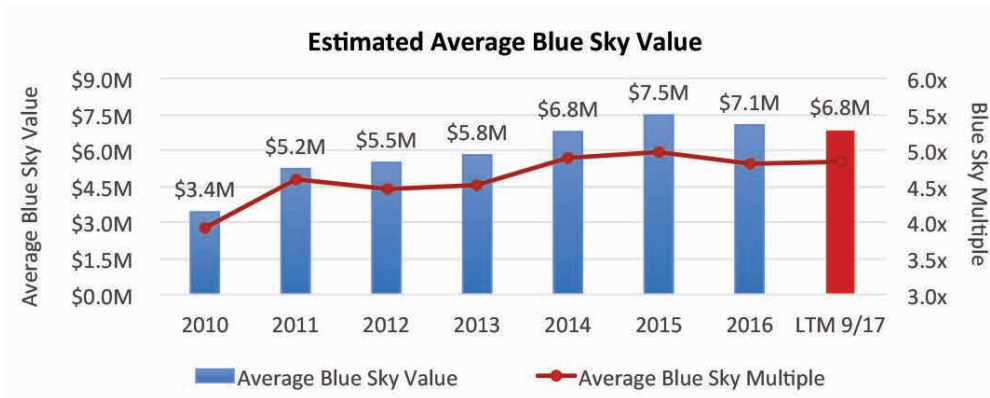
## Sales Growth for Individual Franchises

The following chart sets forth the change in new unit sales at the major franchises for the first nine months of 2017. Note, this data reflects changes in total sales per franchise, so it includes fleet sales that cloud the results at the retail level. Ten of the franchises we track are up while twelve are down, a big change from what we showed in our Year End 2015 Haig Report in which every OEM except VW had sales growth.

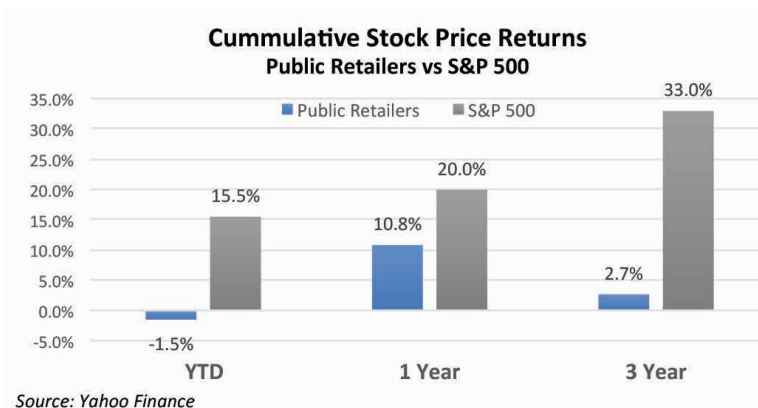


## Dealership Values Declined Slightly

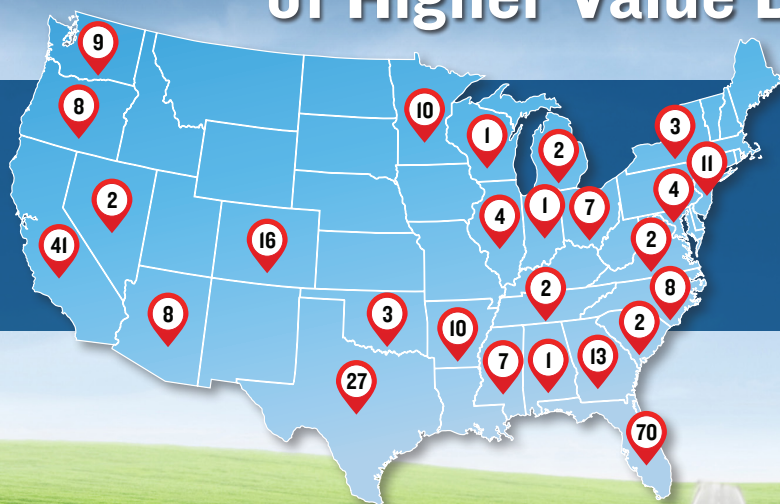
The average blue sky multiple for all franchises on an unweighted basis was 4.85x in Q3, up just a small amount from the 4.82x at the end of 2016, according to our estimates. Trailing twelve month profits per dealership have fallen 3.8% since year end 2016. Applying the 4.85x blue sky multiple to the average dealership pre-tax profit of \$1.411M over the last twelve months generates an average blue sky value of \$6.8M, down 3.2% from year end 2016.



The stock market remains bearish on the public retailers. The table set forth at right shows that the average stock price for the public retailers has underperformed the S&P 500 Index by significant amounts on a year-to-date basis, over the past year, or over the past three years. The one exception to this is Lithia, which has outpaced the growth of the S&P 500, thanks to its sharply higher earnings that are largely due to its rapid pace of acquisitions.



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



**\$3.6 Billion in Value**  
**272 Dealerships**  
**21 Years Experience**  
**1 Trusted Partner**



## DO AUTONOMOUS VEHICLES SPELL DOOM FOR AUTO DEALERS?

Automakers, Apple, Google and dozens of other companies are spending billions of dollars to develop autonomous driving technology. Several people we respect have expressed their concerns that this technology could erode the need for auto dealerships as more people move away from owning and driving vehicles to new ways of paying to get around. We can't dismiss all the money and intelligence being invested in this area, but there remain massive obstacles that need to be overcome before dealers will feel any real negative impacts from autonomous technology. Here are a few of them:

- **High Cost.** The average vehicle sells today for around \$35,000. Given the need for all the hardware, high computing power, data uplinks and all the software, we expect autonomous vehicles will cost well over \$100,000 for many years, too expensive for most consumers.
- **Liability.** In an accident that injures a person today, one driver is liable and his or her insurance will pay for the pain, suffering and other damages of the injured party. For a serious injury, the plaintiffs typically sue for the maximum coverage an individual carries. Wrecks will be less frequent in autonomous vehicles, but they will happen. An autonomous vehicle in a pending collision with a person will have to decide if it hits the child or the adult, the woman or the man, the church van or the school bus and other Sophie's Choice-like dilemmas. And the victim's attorneys will then be suing an OEM with far deeper pockets than any individual's. Unless these OEMs get some kind of indemnification from federal authorities, they will have to price this risk into their business models, which will further increase the cost of autonomous vehicles.
- **Reliability.** Mapping applications frequently give incorrect directions. Recently, Waze said we had reached our destination when there was a fence and a ditch between us and where we wanted to go. Also, when using Uber or Lyft today, consumers frequently need to speak to the driver to coordinate a pick-up location. What happens when the driver is a machine and you can't correct or connect with it?
- **Personalization.** Many drivers need baby car seats or tools for their jobs. Or they want their vehicle to already contain their sunglasses, gum, golf clubs, etc.
- **Convenience.** In suburban or rural areas, the wait times for a pickup may be too long for people already short on time.
- **Job Killer.** If Level 5 autonomy hits the roads, almost all professional drivers will be out of work. Will local, state and the federal government all coordinate to see this happen, or will they work to block it and maintain jobs in their communities?
- **Peak Demand Problem.** Our lives revolve around lots of people using their cars at the same time to get to and from work and school. How will autonomous vehicles cope?
- **Increased Traffic.** Level 5 autonomous cars would be driving empty during half of their trips – on the way to pick up their passengers. Since the number of passenger trips would likely increase in the future, there would be MORE cars on the road at any one time, not fewer. This could make traffic worse for drivers not in autonomous cars, and drive the need for higher public spending for roads.
- **Erosion of Brand Differentiation.** If consumers are no longer driving the vehicle, do they care about how it handles? And if consumers no longer own vehicles, will they care about what brand of pod they are riding in? Is this technology really in the interest of Audi, BMW, Jaguar, Land Rover, Mercedes-Benz, Porsche or even Tesla if consumers will no longer pay a premium for their vehicles? Will BMW become the Ultimate Sitting Machine? Is the technology in the interest of FCA, Ford or GM who make almost all their money from trucks, CUVs and SUVs? How many people will request an Uber ride in an F-150 to go to the grocery store, something that happens millions of times every day now? There will be winners and losers if Level 5 autonomy happens. Will the entrenched interests allow themselves to be cannibalized by a handful of upstarts?

Now that we have raised these obstacles, we also have to say that we have faith in the ingenuity of engineers and software programmers and believe that over time they will solve many of these hurdles and that various forms of autonomous driving could help to save lives and money. We will leave it to others to predict the timing of when there might be an impact, but at the moment, public companies are still buying dealerships and the investment community is still buying their shares. At the risk of being called sarcastic or Neanderthal naysayers, we remind readers of the following two developments that still do not exist in garages around the country.



# BUY SELL TRENDS AND EVENTS

## GPB Makes Its Grand Entrance

Backed by thousands of small investors, GPB is a private equity firm that has built its Capstone Automotive division into one of the largest dealership groups in the US. We have heard that it is raising in excess of \$50M per month to invest in auto dealerships. It has acquired majority stakes in 59 dealerships including Prime Automotive, another private equity backed dealership group in the Boston area. Capstone says it would rank in the Top 10 dealer groups by unit sales or revenue. Capstone is purchasing a majority stake in a dealership group and the existing dealer and his team are staying on to run the dealerships. Some dealers have liked the idea of cashing out most of the value from their company, while also remaining in their chairs and getting a portion of the cash flows. The OEMs have also approved this structure, apparently because it allows dealers to exit larger groups while also increasing the odds of a smooth transition that does not negatively impact customers.

## Deal Volume Is Down, Although Public Spending Is Up

The total number of dealerships that were sold in the first half of 2017 is 17% lower than in the first half of 2016. Public company spending on US auto acquisitions in the first half of 2017, however, jumped 91% over the first half of 2016 as AutoNation, Group 1, Penske and Lithia all closed deals.

## More Sellers Are Coming to Market

As we said earlier, the number of dealers willing to sell their businesses is at a high level today. Some dealers are ready to retire while others may realize that their stores are more likely to decline in value than increase, so they want to sell now rather than waiting for the market rebound. Haig Partners has more ongoing client engagements that at any time in our history.

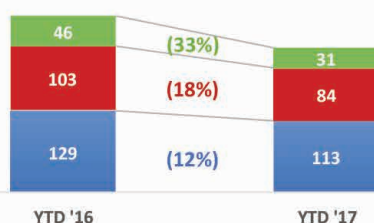
## Buyers Are Pickier

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 a good bit lower than comparable deals in the market to get the attention of buyers. And since profits are likely to trend down, which would likely push dealership values lower, time may work against the interest of sellers. An overpriced dealership will sit until its owners adjust their price expectation, and offers in the future may be lower than what they are currently.

## Sales of Luxury Stores Have Fallen Sharply

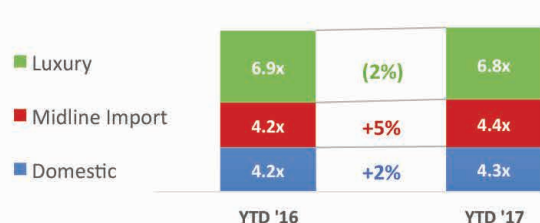
The US auto market has shifted quickly in the past 18 months from cars to trucks. This shift hurt a number of the luxury brands that found themselves with the wrong mix of vehicles at dealerships, hurting profits. Dealership buyers have taken notice as sales of luxury dealerships fell 21% in 2016 compared to 2015 and another 33% in the first three quarters of 2017 compared to the same period in 2016. Blue sky multiples also adjusted with the shift in consumer demand, with average luxury multiples declining and average import and domestic multiples increasing as buyers became more interested in their large lineup of trucks and SUVs. The following tables show how the mix of acquisitions has shifted, and also how the multiples of premium luxury brands, domestic brands, and midline import dealerships have changed over the past year.

Dealership Acquisitions by Segment



Source: The Banks Report and Haig Partners

Haig Partners Average Blue Sky Multiples



# FRANCHISE VALUATION RANGES

We have been involved in the purchase and sale of more than 270 dealerships in our careers dating back to 1996. In the past three years, Haig Partners has been involved in representing buyers or sellers of Aston Martin, Audi, Bentley, Cadillac, Chevrolet, Chrysler-Jeep-Dodge-Ram, Ferrari, Ford/Lincoln, Honda, Hyundai, Infiniti, Jaguar/Land Rover, Kia, Lexus, Maserati, Mazda, Mercedes-Benz, 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 Q2 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 continues to outperform the market, growing 2.7% so far in 2017. The average gross profit per vehicle has fallen as sales of Macans have grown, but the increase in units in operation is leading to record months in dealers' service departments. Porsche stores are rare and the product pipeline looks exciting, so dealers tell us they are highly interested when they come to market. Same multiple range: 7.5x-9.0x.



**Mercedes-Benz.** M-B is down 2.8% so far in 2017, slightly behind the market but extending its lead over key rivals BMW and Lexus. M-B dealerships have higher grosses than Audi or BMW and are capable of generating high levels of profits compared to most other franchises. Some facility spending is coming to meet new image requirements. One negative of the brand is that they continue to add new points that hurt local dealers. We have been involved in the sale of five M-B stores recently and demand has been strong. Same multiple range: 7.0x-8.0x.



**Lexus.** After a nice 2015, Lexus fell 3.9% in 2016 and is down 7.1% so far in 2017. Lexus cars are down a staggering 22.6%! This is partly due to Lexus' decision to back off leasing after losing money on lease returns. But dealers tell us that their margins are higher now, so they are not too upset by the change. Lexus is also adjusting to the shift from cars to trucks, which posted a 4.4% gain. Inventory stood at 51 days on 10/1, down significantly from 77 days on just three months ago. Fixed operations are also strong. Profits per store across the US are back up over \$3M, according to an email we saw recently. We were involved in the sale of two Lexus stores recently and interest was very strong. Same multiple range: 7.0x-8.0x.



**BMW.** So far in 2017, BMW is down 5.1%. Inventories appear to be much healthier than in 2015 and 2016 with the lowest days supply of any brand as of October 2017. Dealers tell us they are playing fewer games with loaner fleets that had been used to inflate sales, but that BMW can still be tricky to work with. With a new X7 on its way and key redesigns coming in 2018 and 2019, we expect BMW dealers will gain back share and boost profits. Facility upgrade requirements can suppress franchise value. Same multiple range: 6.5x-8.0x.



**Audi.** Audi continues to grow faster than the market with sales up an impressive 6.1% so far in 2017. All truck models posted gains and even cars almost matched the market at -2.2%. Audi's SUV factory in Mexico opened in late 2016 to produce the new Q5, which helped alleviate shortages in that product. We have heard profits per store are increasing. While we know of a high performing Audi store that just sold for approximately 9.0x (we tip our hat to the seller!), same multiple range: 6.5x-7.5x.



**Jaguar-Land Rover.** JLR is up 11.5% in 2017, thanks to a 40.5% spike in Jaguar sales. However, inventory is still high at 63 days as of October which must be a shock for dealers who are accustomed to minimal inventories and sky high grosses. Like Porsche, the days of \$10,000 average new vehicle grosses are over as less-costly units are a bigger piece of the pie. The blue sky multiples for JLR are hard to determine today since the factory is exerting leverage on stand-alone Jaguar and Land Rover dealers to combine while also adding a lot of add-points. We are seeing transactions where the Land Rover dealer is paying an exorbitant price for the Jaguar franchise and getting a JLR add-point as a reward. The dealers that don't combine see an add-point in their market given to a third party, which will hurt both of them. It's an effective but rough tactic that JLR is using to get its franchises under one roof and upgrade dealer facilities across the country. For combined JLR stores where no add point is coming, same multiple range: 6.0x-7.0x.



**Cadillac/Acura/Infiniti.** Cadillac sales were down 3% in 2016 and another 4.1% so far in 2017. New products (CT6 and XT5) launched into highly competitive segments and are doing well but are not enough to offset declines in other models. No significant new product arrives until MY 2019. Inventory improved from 96 days on July 1 to 74 days in October. Acura underperformed in 2016 and so far in 2017, down 8.9% and 4.4%, respectively. Acura CUVs have fared OK but cars are declining significantly. Inventory is still a problem at 84 days on October 1, too high for a franchise with limited models. We hope Honda's newly found excitement in its product lineup transfers to Acura quickly. Infiniti is a different story, up an impressive 14.8% so far in 2017 (even cars were +7%). Infiniti has done a good job at creating differentiated products with attractive styling at affordable prices. These near luxury franchises have a hard time making over \$1M, but they can provide nice tuck-in acquisitions. Same multiple range for this group: 3.0x-4.0x.



**Volvo.** After an impressive 2015 and 2016, up 24% and 18%, respectively, Volvo is down 1.4% so far in 2017. The new XC60 should help to revive Volvo's momentum. It will take time for fixed operations to recover as units in operation have likely fallen to the lowest level in decades. Nevertheless, the franchise is alive and might be an excellent value if Volvo continues to launch attractive new products and gain back the share it lost. It still has many loyal customers. Same value range: \$1,500,000 - \$2,000,000.

## Mid-Line Import Franchise Blue Sky Multiples



**Toyota.** Toyota has made a nice recovery recently and is now beating the market with a 2.4% increase so far in 2017. We are hearing margins are up at many Toyota stores thanks to good products and less 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 it gain share. Launches in MY 2018-2019 are car heavy but lots of new trucks are coming in 2020 and beyond, thanks in part to Toyota's new partnership with Mazda to build a \$1.6 billion assembly plant in the US. Dealers continue to love this franchise thanks to high profits per store and a dealer-friendly OEM. Same multiple range: 5.0x-6.5x.



**Honda.** Honda sales grew 4.8% in 2016 and another 0.8% so far in 2017. Honda is unique with cars posting better results than trucks. Loyal customers and a balanced business model of strong variable and fixed operations continue to attract buyer interest. Dealers love the simplicity of running a Honda dealership, although they don't much like the new vehicle gross profits. And customers love the new products from Honda. Same multiple range: 5.0x-6.5x.



**Subaru.** Subaru's sales growth continued in 2016 with sales up 5.6% and another 6.4% through October 2017. Dealers are big fans of Subaru, and it came in second in "Value" in NADA's Summer 2016 Dealer Attitude Survey. With a product lineup that is geared towards CUVs, Subaru continues to take share from its larger rivals. Inventory was the second lowest of any brand with a 41 day supply in October. Higher multiple range: 5.0x-6.0x (with pricing higher in Snow-Belt states).



**Kia.** Sales were up 3.5% in 2016 but are off 7.1% in 2017. Weakness was almost evenly spread across cars and trucks. In the right market these dealerships can make \$1M-\$2M per location, although we also see them struggle in over-dealer markets. There are many Kia stores on the market today. Same multiple range: 3.25x-4.25x.



**Hyundai.** Sales are down 15.2% through October (worst among all major brands). Cars are down 25% while trucks gained 9.4%. The company is shifting its supply of CUVs from other markets to increase availability. Inventory is a growing problem and now stands at 70 days. Expect new CUV products in MY 2019 and beyond as well. Hyundai's plans to reduce the number of Genesis dealers and to establish it as a separate brand concern us. Current demand for Genesis products is anemic with fewer than six units a month per dealer being sold. Even with better products, will stand-alone Genesis franchises be viable? As Subaru has shown, maybe Hyundai should focus its development dollars on building more CUVs and maybe even a light truck instead of trying to enter the daunting luxury market where established brands like Cadillac, Lincoln, Acura, Infiniti and Volvo struggle to attract buyers. There are many Hyundai stores on the market today. Same multiple range: 3.0x-4.0x.



**Nissan.** Sales were up 0.6% through October although much of the sales growth has been through fleet instead of retail sales. The factory executives seem pleased with their success in increasing sales and market share, but many dealers have been screaming that the growth has come at their expense and the brand has been harmed by overly aggressive sales tactics and discounting. New management in Japan seems to be hearing the message and we hear of changes that will help improve profits for dealers in the new vehicle department. On the positive side, units in operation have soared in recent years, consumers really like their products, and dealers who have consolidated markets seem to be doing well. Same multiple range: 3.0x-4.0x.



**Mazda.** After declining 6.7% in 2016 due to a car heavy portfolio, Mazda is almost matching the market so far in 2017, largely due to the well-received CX-5 and CX-9. Mazda has been underweighted in trucks and CUVs and that has cost them sales in this environment of cheap gas. Its new partnership with Toyota should increase supply of CUVs and boost profits. Same multiple range: 3.0x-4.0x.



**VW.** VW dealers are rejoicing with sales up 9.4% in 2017 so far. The new Atlas and Tiguan CUVs are giving a boost but nearly every car model was positive so far this year as well. VW has the highest days supply in the market at over 100, but we wonder if many of these are legacy diesels that have been unsellable. Now that we are past the worst, buyers are more bullish on this franchise. 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 value range: \$1,000,000 - \$2,500,000.

## 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.** Ford sales declined 0.6% in 2016 and another 2.1% so far in 2017. We are perplexed why Ford would be losing share given that its product mix should be an ideal fit for consumers who are increasingly demanding bigger vehicles. Dealers tell us they just want more and better SUVs, CUVs and trucks and Ford has a significant number of these product launches over the next three model years. Dealers compliment Ford's strong captive finance division that helps to drive sales. We have been involved in the purchase or sale of eight Ford dealerships recently. All got significant interest from buyers. Same multiple range: 4.5x-5.5x.



**Chevrolet.** With GM's pivot away from fleet sales, Chevy was down 1.4% in 2016 and another 1.3% in 2017. Results this year might have been better if not for a strike that disrupted supply of the hot selling new Equinox. We applaud the decision to reduce fleet sales as dealers should benefit from higher demand. Consumers are attracted to its truck/CUV/SUV heavy lineup and GM has many of these products it will be releasing in upcoming years that should help it gain share and help dealer profits, especially new full-size pickups and SUVs in MY 2019 and 2020, respectively. Same multiple range: 3.75x-4.75x.



**FCA (Chrysler-Jeep-Dodge-Ram-Fiat).** FCA's sales were even with the market in 2016 but were driven by a 10% increase in fleet sales. So far in 2017, total sales are down 8.4% with only Ram showing an increase. FCA has been trying to shift away from fleet sales like GM. Some buyers love this franchise, while others are wary of FCA's long-term prospects. They don't see the same level of investment in future product as other OEMs and its products are getting a little stale. Truck and SUV launches are heavy in MY 2018-2020 which should help and there is already a lot of excitement around the new Wrangler coming soon. Some dealers like idea of putting Jeep into a separate facility as it will free up service capacity and force salespeople to focus on the CDR products

and used cars, but others are nervous about the idea due to higher costs. There are rumors that Hyundai/Kia is talking to FCA about a merger which might mean better styled and higher quality cars for FCA dealerships and an attractive truck and SUV products for the Korean brands. Who knows! Same multiple range: 3.25-4.25x.



**Buick-GMC.** In 2017, sales are up 0.9% in an overall market that is declining. GMC continues to perform well with its pick-up trucks and SUVs, particularly the new Acadia. However, Buick-GMC inventory is among the highest of the domestics at 117 and 91 days, respectively. New GMC full size pickups and SUVs coming in MY 2019 and 2020, respectively, which should help GM to continue to make fat profits from its large vehicles. Same multiple range: 3.5x-4.5x.

## SUMMARY

Conditions in auto retail have toughened slightly, but are still very robust. Smart dealers are spending lots of time trying to hit their OEM incentive targets, and also working to reduce their costs. Despite the potential risk of new technologies and new entrants, dealerships are still very much in demand and buy-sell activity remains brisk. Dealership values have fallen slightly, along with the decline in profits, but blue sky multiples are little changed. Some franchises are even appreciating in value, such as VW and Subaru. We expect dealers will continue to enjoy good profits for the balance of the year and that buy-sell volume will continue at or near current levels since the returns on invested capital that dealers can get on acquiring dealerships still appear to be higher than other uses for their capital.



Haig Partners is seeing these conditions in our current engagements that range across the US. These transactions include domestic, import and luxury dealerships and range in size from single stores to large sized groups of dealerships. Having been involved in over 160 transactions for more than 270 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. We served as the advisor on two of the largest recent transactions, but we also are pleased to work on smaller transactions where we feel we can add value to the sale process. Our practice has never been busier.



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