The Leading Advisor to Owners of Higher Value Dealerships Is Pleased to Announce Its Most Recent Transaction

“We would like to thank the team at Haig Partners who gave us great advice to help us attract the best possible buyer for our dealership.”

Rusty Reid, Owner of Don Reid Ford

Other Recent Ford Transactions Closed By Haig Partners

Mike Davidson Ford Acquired by ASBURY Automotive Group Florida
Lumberton Ford Lincoln Acquired by ASBURY Automotive Group North Carolina
Texas Motors Ford Acquired by ASBURY Automotive Group Texas
MORRIE’S Ford Buffalo Acquired by fremont Automotive Group Minnesota
Sandy Springs Ford Acquired by ASBURY Automotive Group Georgia
For many dealers, 2016 ended up being their second best year ever. Data from NADA and the public company filings indicate that profits per dealership took a small step back in 2016 as sales flattened and costs rose. We saw the same slight pull back in the M&A market in 2016. Sales of dealerships dropped about 6.5% compared to 2015, perhaps due to concerns by buyers that we had reached the top of the sales and profit cycle in auto retail and that conditions might worsen. We saw buyers became more conservative with their offers, with deals taking longer to get done. Another trend that is impacting the buy-sell market is the shift in consumer preferences from cars to trucks. Franchises that are heavy in cars have seen less demand while transactions of domestic stores, those heavy in trucks, have boomed, up 31% from 2015. Despite the small contraction in 2016, we expect 2017 will be another strong year for buy-sell activity. There remain many buyers looking for dealerships, financing is still readily available, and more sellers are realizing that if they want to sell their dealerships before the next recession, they will likely need to accept today’s offer since tomorrow’s offer could be lower.

That said, the Trump administration is proving to be a big wildcard for our industry. His policies could significantly boost, or kill, demand for vehicles and dealerships. Only time will tell! As the Romans said, “May you live in interesting times.”

**Despite a Dip, The Buy-Sell Market Remains Active**

Three hundred and fifty seven dealerships were purchased by public and private dealers in 2016, a decline of 6.5% from 2015, based upon data from The Banks Report and our internal records. This data excludes the Berkshire Hathaway acquisition of Van Tuyl that closed in early 2015. The decline in the number of dealerships purchased was only 3% during the first six months of 2016 compared to the first six months of 2015, so buy-sell activity in the second half of the year was a good bit lower than the second half of 2015.

Dealership group transactions made up 27% of the total number of transactions in 2016 compared to 21% in 2015. The average group size declined to 3.2 stores from 3.8 stores. Stores that were part of a dealership group represented 55% of all stores sold, up from 51% in 2015. Domestic stores made up 45% of 2016 volume compared to 32% in 2015. Buyers appear to be attracted to these dealerships due to their strength in trucks and SUVs. Luxury and import stores both made up a smaller share in 2016 with 17% and 38%, respectively; these were down from 20% and 49%, respectively, in 2015.
Buyers are telling us that they are more cautious now that it appears we have reached the peak of the sales cycle. But there remains an enormous amount of capital available for deals that are priced attractively. Public companies are coming back into the market, private dealers are on the hunt, and more family offices and private equity firms are also contacting us looking for platforms to acquire. In our opinion, transaction volume has slowed likely because some sellers are unwilling to accept the values they are being offered in the market today that are a little below the values that we saw in 2015, the peak of the market. Luxury stores have suffered the biggest decline in values, due to lower earnings at many stores, as well as lower blue sky multiples. Domestic stores, on the other hand, are enjoying strong profits and strong multiples, so sellers of those franchises are pretty happy right now.

Most of the public companies remain cautious on acquisitions. Group 1, Asbury, and Sonic have spent a combined $16M on auto dealership acquisitions in the US in all of 2016. These three bought back $443M of stock in 2016 and spent more capital on international acquisitions and new business ventures like stand-alone used car stores. Penske has purchased no auto dealerships in the US but continued to invest heavily in the truck industry, spending almost $500M for an additional 14.4% stake in Penske Truck Leasing. Penske and Group 1 spent ~$140M on foreign acquisitions. AutoNation and Lithia have been the most active with each of them buying one large group, along with a number of smaller acquisitions with AN spending $410M and Lithia $234M. AutoNation also purchased $499M of its stock back. The bottom line is that the amount of spending by the publics on acquisitions in the US fell almost 15% from 2015 to 2016. We hope to see all the public companies acquire dealerships in 2017.

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**Public Company Acquisition Spending**

<table>
<thead>
<tr>
<th>Year</th>
<th>Domestic Acquisitions (Enterprise Value)</th>
<th>Foreign Acquisitions / Heavy Truck</th>
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<tr>
<td>2007</td>
<td>$15M (654 M)</td>
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<tr>
<td>2008</td>
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<td>$9 M (502 M)</td>
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<td>2011</td>
<td>$378 M (705 M)</td>
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<tr>
<td>2012</td>
<td>$1,529 M (5,079 M)</td>
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<td>2013</td>
<td>$59 M (573 M)</td>
<td></td>
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<tr>
<td>2014</td>
<td>$689 M (61 M)</td>
<td></td>
</tr>
<tr>
<td>2015</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2016</td>
<td></td>
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*Source: SEC Filings*

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**HAIG PARTNERS: PROVIDING VALUE TO CLIENTS**

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 to optimize the sale of their most valuable asset. We combine the skills gained during our years in investment banking with the experience of buying and selling dealerships for AutoNation and Asbury. We spend a tremendous amount of time and energy on each engagement. Emphasizing quality over quantity best serves our clients’ interests.

Of course, all buy-sell advisors say they are experienced and effective. We encourage any dealer who is considering hiring a firm to ask a few simple questions of the advisor he or she is talking to:

1. How many dealership sales have you, personally (not your firm), closed in your career?
2. Can I speak to your last ten clients to learn about how you added value?
3. Why should I choose you over another advisor?

We enjoy answering these kinds of questions. Haig Partners offers unmatched experience in our industry, and we are pleased to connect you with our former clients for references.
Blue Sky Multiples Are Mostly Unchanged

A number of factors in the market today are impacting blue sky multiples. Profits for many dealerships have fallen from their peak in 2015 and buyers expect there will likely be further declines. Plus, more dealers have entered the market to sell their dealerships. Normally, we would expect that falling profits and increased supply of dealerships for sale would lead to a significant drop in blue sky multiples as buyers would be less motivated and would have greater leverage over sellers. But during the past year we have also seen an increase in the number of buyers. The net result appears to be that multiples for most franchises remain near peak levels except for several premium luxury franchises which have suffered a meaningful decline in demand due to flat to declining sales and an erosion of vehicle margins that together have hurt profits at these franchises.

The table below provides our estimate of what multiple 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 dealerships, 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 estimates rigidly.

The net result appears to be that multiples for most franchises remain near peak levels
POTENTIAL IMPACT OF THE ELECTION ON AUTO RETAIL

Donald Trump continues to be a highly controversial president, but there may be some very positive changes for dealers in the near future. And these improvements could come quickly since the Republicans control all three branches of government.

• **Reduced Regulation.** The CFPB is likely to be muzzled or killed outright, which will protect the critical F&I income stream and allow lenders to provide more capital to dealers and consumers. Escalating EPA requirements regarding fuel efficiency have also just been rescinded, which should allow automakers and dealers to continue to sell high volumes of high profit trucks and SUVs and focus less on selling low margin small cars. Labor issues may head back to historical policies. Health care costs could decline as costly elements of Obamacare are rescinded.

• **Lower Taxes.** Congress is working on tax reform that is likely to lower rates, leaving more money for consumers to purchase vehicles and more money for dealers to expand their dealerships, or buy additional stores. This change could be very substantial. If the tax rates on corporations and pass through entities drops from 40% to 20%, for instance, the amount of after tax cash flow would increase by 33%. So even if pre-tax profits at dealerships are flat or decline in the future, the after tax profits available for dealership owners could be far higher in the future than they have been in the past. This should boost the value of dealerships and help to maintain the robust level of dealership buy-sells that we have enjoyed in recent years.

• **Economic Growth.** Some economists believe that pro-business policies and lower taxes will help expand the size of our economy. Businesses would have greater confidence to hire people, order supplies, and produce goods. Taxpayers would have more money in their pockets to spend, and some of that could be spent on autos. Many investors feel this way as the S&P 500 Index has increased more than 10% since the election (through 3/10/17). Auto sales might start to grow again, rather than shrinking as most analysts predict.

But there are also some real threats from the Trump administration for dealers. It remains unclear what the net effect of his policies, if approved by Congress, will be. But here are some risks for dealers to keep in mind.

• **Higher Interest Rates.** Cutting taxes while boosting spending can be a recipe for inflation. After its recent quarter point increase, many analysts believe the Federal Reserve will increase rates twice more times in 2017. Higher rates reduce demand for cars and increase floorplan expenses.

• **Trade War.** Trump has railed about unfair trade policies. Many dealers sell imported cars and parts. If Congress applies tariffs on imported goods then profits could fall.

• **Real War.** Although President Trump seems less inclined to intervene than some of his predecessors, he also has an image of a tough leader and may resort to military force if provoked, instead of diplomacy.

• **Recession.** If Trump’s policies lead to high inflation and/or erode consumer confidence we could tip into recession.
Overview

Dealers tell us it is getting increasingly difficult to make money. With sales slowing and so much pressure on new and used margins, dealers must now excel at used vehicles, F&I and fixed operations, controlling expenses and be able to carefully manage their assets. One dealer told us, “I am running faster just to stand still.”

Macroeconomic Indicators Are Mostly Positive

There are a number of key factors that influence consumers who are considering purchasing vehicles and most are still trending in a positive direction:

- **GDP Is Growing Faster.** After growing 3.5% in Q3, GDP grew 1.9% in Q4. This is still ahead of GDP growth for Q1 and Q2 of 0.8% and 1.4%, respectively. Q1 2017 GDP growth is forecast at 2.5%.

- **Interest Rates Remain Low.** The average cost for a five-year auto loan was 4.36% per Bankrate.com, still low compared to historical levels.

- **Employment and Household Income Are Increasing.** The US added over two million jobs in 2016 and extended the streak of monthly job growth to 75 consecutive months. The unemployment rate in December stood at 4.7%, the lowest rate in nearly 10 years and was 2.5% for college graduates. Wages grew 2.9% in December, the best growth rate since 2009.

- **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 2.8% in 2016 compared to 2015, according the US Federal Highway Administration.

- **Gas Prices Remain Low.** The Department of Energy reported that the average price per gallon of fuel was $2.14 during 2016, down from $2.43 in 2015 and $3.62 in 2012. The average household saved $300-$400 on gas in 2016 compared to 2015.

- **Consumer Sentiment is High.** There is a strong correlation between auto sales and consumer sentiment. As the chart at right shows, consumer sentiment remains near historically high levels, thanks to a sharp bump after the election. Despite all the controversy over Trump, consumers have a positive outlook and that is helping to keep new and used vehicle sales near record high levels.

While the economy is doing well overall, there are a few indicators heading in the wrong direction and these are giving some dealers concerns about the future:

- **Used Car Pricing Is Declining.** NADA’s Used Vehicle Price Index in January was down 6.5% from January 2015 and remains at the lowest level since 2011. We are hearing of some OEMs taking heavy losses on their vehicles coming off-lease. Lower used car prices can affect new vehicle sales as they make it more difficult for owners to trade in their vehicles for new ones. Also, lower residual values on used cars will likely drive up the costs of auto leasing which would hurt new vehicle sales.

- **Incentive Spending Increasing.** Incentive spending in February increased 14% year over year per ALG, raising the concern that true demand for vehicles is weakening. According to JD Power, February was the eighth consecutive month where incentives...
TRENDS IMPACTING AUTO RETAIL

were at or above 10% of MSRP. Perhaps more surprising, according to the Wall Street Journal, many OEMs are now spending more on incentives to sell a vehicle than on the cost of labor to produce a vehicle!

Loan Losses Are Increasing. While auto loan balances have exceeded $1 trillion for the first time, some lenders are seeing higher charge-off rates. The subprime sector is deteriorating fastest, with net losses hitting 8.9% in August, up from 7% a year earlier and 5.9% the year before that, according to the Wall Street Journal.

Profits at Some Dealerships Are Declining. Per NADA, profits for the average privately owned dealership fell 2.4% in 2016 compared to 2015. Public company filings show operating income falling at three of the six publics in 2016 compared to 2015, with the group down 0.5%, despite a significant amount of acquisition spending by several of them.

2016 New Vehicle Sales Hit 17.5M Units Helped by Fleet; 2017 May Be Slightly Down.

After matching record high sales of 2015, total retail and fleet sales in January and February 2017 were down 1.5% compared to the same months in 2016 with the same selling days. In the chart below we show an estimate from NADA for 2017 of 17.1M units, representing a 2.2% year/year decline.

And while total new vehicle sales hit 17.5M units again in 2016, it is important to note that fleet sales were 4.1% higher so retail sales were slightly down from 2015. So far in 2017 retail sales are holding up well. In the chart at right, JD Power shows that the US Retail SAAR improved at the end of 2016 and the 3-month average ending February 2017 is higher than it was for much of 2016.

Vehicle Grosses Continue to Decline

The complaint we hear most often from dealers relates to the continued decline in gross profit per vehicle. New vehicle profits were down 2.3% for the year in 2016 for the public retailers, better than the 4.9% decline in 2015. Used vehicle gross profits were down
3.6% in 2016, also an improvement from the 5.3% decline in 2015. Several OEMs claim they are trying to reverse these declines via changing their advertising policies or ending stair-step programs, but so far profits per car continue to fall.

Finance & Insurance Departments Are Generating Record Profits

Gross profits from F&I continue to grow, offsetting the decline in gross profits per new and used vehicle sold. In 2016, the public groups reported gross profit per vehicle retailed reached $1,410, up 3.6%, or $51 per vehicle, from 2015. All of the publics improved in this area, though the rate of improvement was the slowest of the last seven years.

Fixed Operations Driving Higher Profits

Almost seven years of rising sales have significantly increased the number of units in operation. Also, the big spike in recalls that involve many millions of vehicles has been another boost for service departments. Private dealers reported fixed operations increased a whopping 8% for 2016. Public retailers also did well, averaging 2.7% growth on a same-store basis in 2016 compared to 2015. It is unclear why private dealers captured so much more repair business relative to the publics. Higher profits from fixed operations may continue to support dealership profits even if vehicle sales and/or margins worsen.

Dealership Expenses Are Growing Faster Than Gross Profit

NADA data shows the average dealership in the US during 2016 enjoyed a revenue increase of 5.1%, an increase in gross profit of 3.0%, but an average increase in SG&A costs of 6.5%. SEC filings indicate the public companies fared similarly in 2016 with revenue up 3.6%, gross profit up 3.1%, but SG&A up 4.1%, all on an adjusted basis. Some of this increase is due to higher labor and facility costs, but the publics reported higher floorplan expense for the first time in recent memory. We expect smart dealers will be highly focused on reducing costs in a mature market, and a number of the public companies have announced they have been taking steps to reduce inventory, personnel and other costs.
Dealership Profits Drop Slightly

The net outcome of the trends listed above is that pre-tax profits at dealerships declined 2.4% from 2015 to 2016 to $1.467M, according to NADA. This is still a very robust level, the second best on record, and many dealers we spoke with are still pleased with their results.

The table below shows the annual change in profits at privately owned dealerships since 2009. The seven-year run in growth of profits at dealerships came to an end in 2016. Future profits per store are difficult to predict. Prior to the Great Recession, during the 2001 to 2007 period when new vehicle sales were essentially at a plateau, previous 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’s also possible that if the US economy continues to expand we will see profits stay at the current level, or even grow again.

After being down 2.0% in profit through Q3, public retailers had a strong Q4 with 4.5% growth, ending the year down 0.5% compared to 2015.
Sales Growth for Individual Franchises

The following chart sets forth the changes in new unit sales at the major franchises for 2016 compared to 2015. This same chart had only one brand in decline just one year ago. Now we see about as many franchises suffering sales declines as enjoying sales increases. Jaguar and Land Rover continue their sales explosions, while Subaru, Porsche, Honda and Audi had solid gains at the retail level. Nissan posted a gain but it was due to a large increase in fleet sales. BMW ended up losing the largest amount of sales, followed by Acura and VW.

THE TEAM

Alan Haig, President.

For six years prior to establishing Haig Partners, Alan led the auto retail practice at The Presidio Group where he closed numerous transactions, including two that he believes achieved record high levels of goodwill for the franchises involved. Before that, he was Senior Vice President of Corporate Development at AutoNation, Inc., the world’s largest auto retailer, leading its dealership acquisitions and divestitures. He was also at AutoNation in its earliest days and wrote the original business plan for the new car division and then began leading dealership acquisitions. Through these positions, Alan has been involved in the purchase or sale of more than 160 dealerships with a value of approximately $2.4 billion. In his career, Alan has closed transactions with a value of over $5.7 billion.

Alan holds an MBA from Columbia Business School, an MA from the University of North Carolina and a BA from Dartmouth College. He lives in Ft. Lauderdale, FL with his wife and their four children.

Nate Klebacha, Partner.

Before helping to establish Haig Partners, Nate served as Vice President and then Principal at The Presidio Group where he was responsible for dealership analysis, preparation of marketing materials, responding to due diligence requests from buyers, and assisting in closing transactions. Prior to Presidio, Nate spent six years with Asbury Automotive where he was involved in the purchase or sale of more than 50 dealerships for more than $500M. Before Asbury, Nate held positions at O’Shaughnessy Capital Management and Bear Stearns Asset Management as assistant portfolio manager.

Nate holds an MBA from the NYU Stern School of Business and a BS from the University of Connecticut. He lives in Weston, CT with his wife and their three children. (Welcome, Baby Alex!)

Pat Carroll, Managing Director.

Pat joins Haig Partners after more than 25 years in the heavy truck dealership industry. Pat served as President and Dealer Principal of Freightliner of Chattanooga and Freightliner of Knoxville from 1990 through February 2015 when the businesses were sold to Penske Automotive’s commercial vehicles division. During this period, he worked in all capacities. He led the design and construction of two state of the art dealership facilities, developed and maintained one of Daimler Trucks’ largest parts accounts, managed customer, manufacturer and vendor relationships, as well as developed a strong team of long-term valuable employees and managers. Pat received his Bachelor of Aerospace Engineering (B.A.E.) degree from Auburn University and pursued graduate studies at Princeton University and the University of Alabama.

Mike Toth, Vice President.

Prior to Haig Partners, Mike served as Business Development Director at MEDNAX, Inc., a leading provider of physician services, where he was involved in acquisitions with a value of more than $800 million. Prior to that, Mike was the Director of Corporate Development at AutoNation, Inc., where he worked on the purchase or sale of approximately 40 dealership transactions with a value of more than $400 million. He also held positions at AutoNation managing the floorplan facilities and financial risk management programs. In addition, Mike held various operating and financial positions at Office Depot where he was responsible for retail categories with over $1 billion of revenue and participated in approximately 500 real estate projects.

Mike is a CFA® charterholder and holds an MBA from Florida Atlantic University and a BS in Accountancy from Villanova University. He lives in South Florida with his wife and two children.
BUY SELL TRENDS AND EVENTS

Dealership Values May Have Peaked Along with Blue Sky Multiples

We estimate that the average blue sky multiple for all franchises on an unweighted basis was 4.66x in Q4, a decline of 2.9% from the Q4 2015 average multiple of 4.80x. We believe we have passed the “peak” in terms of blue sky multiples, and now likely blue sky values. As stated previously, the average profit per dealership according to NADA declined slightly in 2016 from 2015. Applying the 4.66x blue sky multiple to the average dealership pre-tax profit of $1.467M in 2016 generates an average blue sky value of $6.83M, down 5.4% from 2015.

For most of 2016 the public retailers underperformed the S&P 500 Index by about 20% as investors became concerned about the sales cycle and believed other stocks had better prospects. Their values fell much more than the decline we saw in the value of private dealerships. After the election there was a brief rally in these publics’ stock prices that narrowed the gap to around 10% of the S&P 500 performance, but they fell back in the past few weeks since they released their 2016 year-end numbers.
Overpriced Dealerships Have Little Chance of Selling

In previous years, when dealership profits were on the rise and there were few dealerships for sale, we had the luxury of getting strong offers for almost every business that we brought to market. And if our clients were not satisfied with the offers we were bringing them, we could wait a bit, update their pre-tax profit figures, which had increased during our marketing process, and return to the market with an even more valuable business. There were more buyers than sellers so pricing was strong and the odds of success in selling a business were very high. Buyers moved quickly to lock in deals.

Today, profits are trending down, buyers are more cautious and there are more stores available for them to choose from. The market has shifted and become more balanced between buyers and sellers. For a dealership to sell today, it must be priced to provide buyers with an attractive return on investment at the time of closing. And since profits are likely to trend down, which may push dealership values down, time will work against the interest of sellers. An overpriced dealership will sit until it is repriced, and that price may well be lower than what the store might have sold for had it been priced correctly from the outset. And dealerships that have a lot of “hair” such as facility issues, unions, or incoming add-points will need to be priced a good bit lower than other deals in the market to get the attention of buyers who can now choose from turn-key acquisition opportunities.

Public Companies Are More Focused on Share Repurchase Than Acquisitions

Only AutoNation and Lithia have made any meaningful acquisitions of US auto dealerships in 2016. The $661M spent on US acquisitions in 2016 by the publics was off 14% from 2015 and was nearly matched by their investments in heavy truck industries and foreign auto dealerships. The public companies have also increased their share repurchases from $760 million in 2015 to $1.23 billion in 2016, an increase of 61%. Stock purchases are a way to return cash to shareholders, but they also reduce the denominator in the Earnings Per Share calculation, thereby helping boost stock prices which is how most of their CEOs are measured. AutoNation has announced it will be making major investments in used car dealerships, auction houses, and collision centers, so its capital will be limited for auto dealership acquisitions. Sonic and Asbury have not announced any big acquisition plans. Penske has become active again in the US market, on the luxury side. Lithia is likely to be the most active acquiror again in 2017. With most public companies largely on the sidelines, the window is open for private groups and new investors to make acquisitions at prices lower than we have seen in recent years.

Institutional Investors Are Active

Family offices and private equity funds were more active in acquiring dealerships than the public companies in 2016. These investors include RFJ Partners, Leucadia/Ken Garff (outside of Utah), McLarty Auto Group (Soros backed), GPB Capital, The Fremont Group, and other smaller firms. And there are many more investors like these hunting for large platforms to acquire. Some of these firms now have critical mass and are purchasing one or two stores at a time as they fill in existing markets. Other firms are seeking large platforms with talented management teams that will stay on board and grow the group after an investment is made. These investors are
highly focused on return on investment rather than brand mix or market area. They are patient and some can write a check of any size necessary to provide a full or partial exit for dealers that are considering diversification, liquidity or retirement. We believe owners of large dealership groups should carefully consider these investors as a viable option when planning for the future.

**Potential Returns on Investment When Factoring in a Recession**

In our past reports, we have shown simple Return on Investment calculations on acquisitions that assumed cash flows would remain constant over time. We thought it might be useful to show how some dealership buyers view the potential returns on investment from acquisitions over a ten year period that include a recession. We looked at three basic scenarios to consider a range of possible outcomes from a dealership acquisition. For acquisition price, we used our average blue sky multiple of 4.66x against the NADA average pre-tax earnings per store of $1.467M to get a total of $6.83M in goodwill. In addition, we factored in working capital equal to another year of earnings, or $1.467M, for a total investment of $8.3M.

- **Scenario 1 - Growth:** Profits increase by 15% over three years, then a recession occurs in which profits fall 20% below their peak, and then profits return to peak over the next three years before the dealership is sold for the same multiple paid.
- **Scenario 2 - Flat:** Profits remain the same for two years, a recession occurs in which profits fall 20% below their peak, and the profits return to original levels for five years before a sale for the same multiple paid.
- **Scenario 3 - Decline:** Profits fall 20% and never recover. Sale occurs in ten years at a multiple 1x lower.

The following table shows the projected pre-tax cash flows and Internal Rates of Return from these acquisitions on an unleveraged and leveraged basis. The leveraged scenarios assume a 10-year loan of 50% of the total purchase price at a rate of 4%. These returns far exceed the kinds of returns available to most dealers from other investment opportunities and demonstrate that even in a recession, dealership acquisitions can adequately service their debt.

### PRE-TAX CASH FLOW - UNLEVERAGED

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<thead>
<tr>
<th>Scenario</th>
<th>Initial Investment</th>
<th>10 Years of Profits</th>
<th>Sale Proceeds</th>
<th>IRR</th>
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<td>1 - Growth</td>
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### PRE-TAX CASH FLOW - LEVERAGED

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As seen in the tables above, dealership valuations remain healthy because they provide a return to buyers that exceeds almost any other kind of investment available on the market today, so long as they expect to hold the investment for ten years or more. And remember, if we experience any amount of inflation over the next ten years, these returns would be even higher. Of course, actual returns could vary substantially from these scenarios.
Buyers Are Shifting Their Focus From Luxury Stores to Domestic Stores

The US auto market has shifted quickly in the past 18 months from cars to trucks. This shift has hurt a number of the luxury and midline import 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 sharply by 21% in 2016 compared to 2015 and sales of import dealerships fell even more, by 25%. But the shift has benefitted the domestic brands that have traditionally been weighted towards trucks and SUVs. Buyers follow the money and they acquired a whopping 31% more domestic stores in 2016 than in 2015. Domestic brands would have seen a bigger increase in their blue sky multiples, but there are some ten thousand domestic dealerships that operate in the US, so buyers have numerous options to acquire domestic stores without paying a large multiple. The tables below show how the mix of acquisitions has shifted over the past year, and also how the multiples of premium luxury brands, domestic brands, and midline import dealerships have changed over the past year.

Sales of Dealership Groups Are Increasing

Buyers purchased 60 groups in 2016 compared to 51 groups in 2015, an uptick of 17.6%. We believe this trend will continue in 2017 as multi-store owners who are at retirement age decide to sell now before the market deteriorates further. Public companies will sometimes make sizeable acquisitions, but more often we see large privately owned dealership groups writing these large checks. And new institutional investors have arrived that are looking for platforms that they can acquire and grow. Lenders remain bullish and are willing to provide substantial debt for buyers. And with the improving chances of lower capital gain taxes, sellers may be able to keep more of their hard earned sales proceeds. We believe 2017 is kind of a Goldilocks moment for buyers and sellers of groups. Buyers think that values have declined slightly so they are no longer buying at the top, and sellers may realize that if they don't sell now, they may need to ride out the downward portion of the sales cycle and then the subsequent recovery before they could get back to the value of their businesses today.
We have been involved in the purchase and sale of more than 270 dealerships in our careers dating back to 1996. In the past two 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 of what buyers in competitive situations will pay for the goodwill of dealerships and we note any upward or downward changes from Q3 2016. In our opinion, dealers are going to have a more difficult time getting offers in the ranges we discuss below without a true marketing process because buyers are looking at more deals today than at any time in recent memory. Sellers are going to need to present their businesses to numerous parties to be confident of getting a good result. 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, while 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 outperformed the market, growing 4.9% in 2016 and another 4.1% so far in 2017. Per unit gross profits have declined from their stratospheric heights due to increased inventories and a higher mix of lower priced/margin Macans. Given the significant growth in units in operation, we expect dealers will be enjoying a boom in fixed ops. Inventory could become an issue as there was a 79 day supply as of March 1, far higher than normal. Porsche stores are rare, and dealers tell us they are highly interested when they come to market. Same multiple range: 7.5x-9.0x.

**Mercedes-Benz.** After a tough start to 2016, M-B finished even with the market. 2017 is off to a strong start and is up 5.5%. M-B outperformed Lexus and BMW in both periods. M-B dealerships are capable of generating high levels of profits and dealers are pleased with M-B’s leadership. M-B’s recent commitment to give dealers a 10 year break on facility upgrades should also be viewed as a positive, allowing dealers time to earn a better return on their investment. One negative of the brand is that they continue to add new points that hurt the neighboring dealers. We have been involved in the sale of five M-B stores recently and demand was strong, but buyers have become more cautious due to the shift from cars to trucks. Slightly lower top end: 7.0x-8.0x.

**Lexus.** After a nice 2015, Lexus was down 3.9% in 2016 and is down a staggering 23% so far in 2017 with no models posting a gain. We are hearing that Lexus is losing a lot of money on its lease returns due to residual values that were set too high so it has backed off leasing, with scary effects as these customers are defecting to other brands. Lexus is also adjusting to the shift from cars to trucks. Inventory has ballooned to 92 days! That said, dealers still love Lexus and it came in first in “Value” in NADA’s Summer 2016 Dealer Attitude Survey. We were involved in the sale of two Lexus stores in 2016 and interest was very strong. Buyers are likely to be concerned about the sharp drop in sales so far in 2017 and what it implies for future profits. Slightly lower top end: 7.0x-8.0x.

**BMW.** BMW declined 9.5% in 2016 as it reduced the supply of sedans to reduce inventory of those units but was not able to ramp up production of its SUVs to offset the lost volume. Also, some dealers have begun to resist punching cars or putting too many units into their loaner fleets. So far in 2017 BMW is slightly ahead of the market and inventories appear to be much healthier, so hopefully the worst is behind this brand. BMW is doing well with SUVs and the refresh of the 3 and 4 series, but the 5 series is down nearly 50% ahead of a full redesign soon to be released. With key redesigns coming in 2017 and 2018, we expect BMW dealers will gain back share and boost profits. Facility
upgrade requirements continue to be a challenge for some dealers, and these requirements can suppress franchise value. Despite its recent issues, acquisition opportunities for BMW stores are rare, so buyers remain highly interested whenever one becomes available. Same multiple range: 6.5x-8.0x.

**Audi.** Audi continues to grow faster than the market with sales increases of 11% in 2015 and 4% in 2016. In the first 2 months of 2017, Audi is up 14.3%! Audi’s SUV factory in Mexico opened in September to produce the new Q5, which will further boost Audi’s production of higher margin SUVs that have been in limited supply. Audi has largely worked through an excessive amount of inventory that was suppressing margins, and has altered its Business Plan Objective system to make it easier for dealers to achieve bonuses. We have also heard they will be reducing the costs of their loaner car program and making other changes to address dealer complaints of low profits for Audi stores compared to other luxury brands. Same multiple range: 6.5x-7.5x.

**Jaguar-Land Rover.** JLR was up an amazing 26% (37% for Land Rover alone) in 2015 and another 24% in 2016. JLR is up another 23% so far in 2017 with Jaguar up 124% (thank you XE and F-Pace!). These new models, along with the upcoming Land Rover products, should help JLR stores better compete with other luxury brands that have a broader line-up of vehicles. However, margins have fallen on Land Rovers due to higher inventory levels (70 days) and a new margin structure. The multiples for JLR are hard to value at the moment since the factory is exerting leverage on stand-alone Jaguar and Land Rover dealers to combine while also adding a large amount of add-points. We are seeing transactions where the buyer, usually the Land Rover owner, is paying an exorbitant price for the sister brand but getting a JLR add-point in a contiguous or distant market as a reward. The dealers that don’t combine may see an add-point given to a third party, which will hurt both existing 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 3% in 2016 and another 6.5% so far in 2017. New products (CT6 and XT5) launched into highly competitive segments have not helped performance. Inventory stood at 107 days on March 1. Cadillac is working on a plan to reduce the number of dealers who stock their cars, but dealers are resisting and little progress appears to have been made. We understand Cadillac’s logic. Unless Cadillac dealerships can sell substantially more vehicles per location, its dealer body will never be able to match the luxury experience offered by its German competitors, but they will need to pay small dealers more to convince them to give up their franchises. Acura underperformed in 2016 and so far in 2017, down 8.9% and 12.8%, respectively. Acura SUVs have fared ok but cars are declining significantly. Inventory was 106 days on March 1. Infiniti was up 3.6% in 2016 and a strong 33.9% so far in 2017 (even cars were +19.6%). These near luxury franchises have a hard time making over $1M in most markets, 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 14.5% so far in 2017. Perhaps the market for its popular XC90 is already saturated or prices are set too high. The new XC60 should help continue 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 can be a nice tuck-in if facility costs are modest. Higher value range: $1,500,000 - $2,000,000

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**Mid-Line Import Franchise Blue Sky Multiples**

**Toyota.** After being slightly behind the market in 2016, Toyota sales were down a surprising 6.2% so far in 2017. Truck sales were healthy but not enough to offset steep declines in cars. And inventories are up to 65 days on March 1. There is a good chance February may mark the last month of a Corolla or Camry being the highest selling Toyota with the RAV4 crossover poised to unseat them. High profit per store and a dealer-friendly OEM continue to attract lots of buyers. We have seen a couple of Toyota transactions lately where buyers paid healthy prices, perhaps reflecting a “flight to quality” in a time of flattening new vehicle sales. Slightly higher top end multiple: 5.0x-6.5x.

**Honda.** Honda sales grew 4.8% in 2016 and another 5.9% so far in 2017. Also as a sign of the times, the CR-V was the best-selling Honda, beating out Accord and Civic. Its new or redesigned products are selling well. Bank of America / Merrill Lynch’s latest Car Wars report predicts that its updated core products, along with new models, will make Honda the fastest growing major OEM over the next three years with a replacement rate of 96% compared to the industry average of 80%. Loyal customers and a balanced business model of strong variable and fixed operations continue to attract buyer interest. Dealers love the predictability of the Honda business model and Honda stores also appear to be enjoying the “flight to quality” that we mentioned above. Slightly higher top end multiple: 5.0x-6.5x.
**Subaru.** Subaru's sales growth continued in 2016 with sales up 5.6% and another 7.5% through February. Dealers love 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 and with advertising that is appealing to Millennials, young families and educated older folks, Subaru continues to take share from its larger Japanese and Korean rivals. While all the growth is fun for dealers, we wish there were more margin in the products. Inventories have also been creeping up, although still one of the lowest in the industry. Buyers may need to expand dealerships to handle the higher sales and service volume. Same multiple range: 4.0x-5.0x (with pricing higher in Snow-Belt states).

**Kia.** Sales were up 3.5% in 2016 but are off 11.1% in 2017 as the previously best-selling Soul was down 26%. We have been involved with several Kia franchises recently and we have been impressed with the profits that good dealers can generate. This franchise can provide a high ROI to buyers as the multiple is relatively low and real estate costs are less than most other brands. Same multiple range: 3.25x-4.25x.

**Hyundai.** Sales beat the market in 2016, gaining 1.7% and another 1.5% through February, largely driven by fleet sales. The company is shifting its supply of CUVs from other markets to increase availability. We are concerned about its plans for the Genesis brand as we feel that Hyundai might force dealers to move those products into stand-alone facilities. Same multiple range: 3.0x-4.0x.

**Nissan.** Sales were up 5.5% in 2016 and 2.3% through February, although all of the sales growth has been through fleet, as its retail sales are down slightly. We have already described Nissan's strategy of encouraging “preferred dealers” to consolidate markets in previous reports so we won’t repeat it again. Dealers complain more to us about Nissan than any other franchise and they gave Nissan poor ratings in NADA's Summer 2016 Dealer Attitude Survey. We believe a lot of franchise value is being eroded here so long as Nissan remains heavily involved in selecting its dealers. Same multiple range: 3.0x-4.0x.

**Mazda.** After declining 6.7% in 2016 due to a car heavy portfolio, sales are up 7.9% so far in 2017, largely due to the CX-9. Mazda has been underweighted in trucks and CUVs and that has cost them sales in this environment of cheap gas. Few buyers seek Mazda as a stand-alone acquisition, but like the returns they can get from them as a part of an acquisition. Same multiple range: 3.0x-4.0x.

**VW: Drivers Wanted Products Needed.** VW resolved its Dieselgate scandal late last year. Sales were down just 7.6% in 2016. We expected much worse results given that dealers had limited options for customers in a market skewed towards CUVs. VW is up 14.8% in 2017 so far, thanks to customers coming to dealers to return their diesel vehicles in return for substantial cash payments. We hear less than 30% of these customers are buying new VWs, much lower than a normal retention rate of about 50% for many brands, which means too many customers are tossing back the keys and headed towards the competition. Many of these diesels will end up being scrapped, which will reduce the number of units in operation. This is not great news for VW service departments unless they can also repair many of these units. At least VW paid the average dealer $1.85M for his suffering from this scandal. VW does have important new products coming with the Atlas 3-row SUV and a new Tiguan. Now that we are past the worst, we would expect an uptick in buyer appetite for this franchise. Higher value range: $500,000 - $2,000,000.

**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.** Ford sales declined 0.6% in 2016 and another 3.3% so far in 2017. Fleet helped prop up sales in the first half of 2016 but they have moderated in the back half and into 2017. Ford’s product mix should be an ideal fit for today’s environment of low gas prices. Thankfully, Ford has dropped its step program that was unpopular with dealers and hurting profits at many stores. Despite a few hiccups, Ford is still seen as the best positioned domestic OEM. 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. However, retail share was improved and sales are up 1% so far in 2017. Consumers are attracted to its truck/CUV/SUV heavy lineup. Some dealers are worried that a mature sales environment will make it increasingly difficult to qualify for GM’s SFE incentive programs and they are hoping GM will modify this program. If not, then profits could fall substantially at many dealerships. 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, sales are down 10.6% with only Ram showing an increase. With sales declining, dealers see FCA’s stair step programs that depend upon higher sales as unrealistic and in need of adjustment. Some buyers love this franchise, while others are wary of FCA’s long-term prospects. We are a little worried about the idea of putting Jeep into a separate showroom. Same multiple range: 3.25-4.25x.

Buick-GMC. Sales were down only 0.7% in 2016 even as GM pulled back on fleet sales. In 2017, sales are up 0.3%. GMC continues to perform well with its pick-up trucks and SUVs, particularly the new Acadia. Dealers have the same SFE concerns as Chevrolet dealers. The ongoing shift to trucks and SUVs should help this franchise more than most. Slightly higher multiple range: 3.5x-4.5x.

SUMMARY

While we may have passed the peak of the market in terms of dealership profits and values, we are still close to record high levels and the buy-sell market remains highly active. Private dealers have access to lots of capital and are pursuing deals. Publicly traded dealer groups are still active, although less than in the past. And new entrants like private equity firms and family offices continue to work to deploy large amounts of capital buying dealerships. We expect 2017 to be a dynamic period in dealership buy-sells, although some of the “froth” we saw in late 2015 and early 2016 has been blown away.

Haig Partners is seeing these conditions in our current engagements that include domestic, import and luxury dealerships and range from Florida to New York to California. We know of no other firm that 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. The value of the transactions that we have closed over the past two and a half years is approximately $900M, excluding new vehicle inventory values, which works out to be over $50M per transaction and $25M per dealership. We served as the advisor on two of the largest transactions in 2016, but we also are pleased to work on smaller transactions where we feel we can add value to the sale process.
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