TRENDS IN AUTO RETAIL AND THEIR IMPACT ON DEALERSHIP VALUES

- Economic conditions continue to recover
- Dealership profits have set records in recent months
- Public company spending has reached record levels
- Blue sky values are close to record high levels
- Public equity valuations are 40% higher than they were before the pandemic
- SEE PAGES 4 AND 16 FOR OUR OUTLOOK ON THE INDUSTRY AND BUY- SELLS
OVERVIEW

Dealers continue to pinch themselves for their good fortunes. Profits exploded in the third quarter thanks to higher gross profit and lower expenses. It’s hard to believe, but dealers are well on their way to having their best year ever in the midst of the pandemic.

These good times have restarted the consolidation of the industry which had stalled in Q2 as dealership buyers pulled back due to required store closings and scary headlines. We are 9% above last year in terms of dealerships sold in Q3 and only 7% below 2019 for YTD Q3 figures, but the pace of acquisitions is quickening. Private groups are active again as are the publics. Notably, Asbury Automotive and Lithia Motors have made massive bets and will drive the amount of money spent by public retailers to an all-time high this year.

Investors have noticed that dealerships are essential businesses with multiple profit centers that can be countercyclical. As a result, the stock prices for the public retailers have all jumped and are now trading at higher prices than before the pandemic. Prices for privately-owned dealerships have also increased. We saw a decline in values at the end of Q1 and in Q2 as buyers were worried about future earnings. But now that dealerships are making record profits, we have seen buyers become much more aggressive in their offers and we estimate that privately-owned dealerships have appreciated in value above where they traded at the end of 2019 and are approaching their highest levels ever.

It seems almost unfathomable to many that this public health catastrophe has resulted in such significant financial benefits to auto dealers. No one can overlook the financial and personal losses that the pandemic has created for millions of people. Our hope is for a vaccine that can protect us all early in 2021. In the meantime, dealers are absorbing the lessons taught to them by COVID and finding ways to improve their businesses and better serve their customers.
Buy-Sell Activity Is Rebuilding Toward Pre-COVID Levels

COVID had a significant impact on the buy-sell market. Buyers had been purchasing an average of 25 to 30 dealerships per month over the past few years. In 2020, the market was maintaining this pace from January - March before buyers became alarmed at the potential impact of the coronavirus and pulled back from buying stores. Closings in April and May dropped to under five per month, a decline of about 80%. Once customers returned to showrooms and dealership profits began rebounding, so did the buy-sell market. In Q3 2020, we saw 95 dealerships change hands, a 9% increase compared to Q3 2019. Over the last nine months, buy-sell activity is down 7% compared to the same period the previous year due to the collapse of Q2.
Public Company Acquisition Spending Has Reached Record Levels

The previous tables showed that the number of dealerships bought/sold by publicly-traded and privately-owned companies so far in 2020 declined compared to 2019. The amount of spending by public companies, however, exploded in Q3 2020. The massive increase in spending is attributable primarily to Asbury’s and Lithia’s acquisitions of stores in Texas that totaled $138B in Q3. A total of $157B has been spent in the first three quarters of 2020 on domestic acquisitions by the publics, a 247% increase compared to the same period in 2019. In fact, the amount spent by the public auto retailers in just nine months in 2020 exceeds any other full year in the history of our industry.

This level of spending matters for several reasons.

• Asbury and Lithia are putting the other publicly traded companies under pressure to acquire or risk being left behind
• It shows there is a market for even the largest dealership groups
• Other buyers become more confident that they should also be growing in this environment
• Dealership values are boosted by strong demand

Public Company Acquisition Spending

<table>
<thead>
<tr>
<th>Year</th>
<th>Domestic Acquisitions (Enterprise Value)</th>
<th>Foreign Acquisitions / Heavy Truck</th>
</tr>
</thead>
<tbody>
<tr>
<td>2009</td>
<td>$14 M</td>
<td>$12 M</td>
</tr>
<tr>
<td>2010</td>
<td>$3 M</td>
<td>$504 M</td>
</tr>
<tr>
<td>2011</td>
<td>$12 M</td>
<td>$202 M</td>
</tr>
<tr>
<td>2012</td>
<td>$20 M</td>
<td>$685 M</td>
</tr>
<tr>
<td>2013</td>
<td>$397 M</td>
<td>$1,529 M</td>
</tr>
<tr>
<td>2014</td>
<td>$1,529 M</td>
<td>$59 M</td>
</tr>
<tr>
<td>2015</td>
<td>$59 M</td>
<td>$773 M</td>
</tr>
<tr>
<td>2016</td>
<td>$639 M</td>
<td>$661 M</td>
</tr>
<tr>
<td>2017</td>
<td>$477 M</td>
<td>$1,015 M</td>
</tr>
<tr>
<td>2018</td>
<td>$232 M</td>
<td>$766 M</td>
</tr>
<tr>
<td>2019</td>
<td>$431 M</td>
<td>$697 M</td>
</tr>
<tr>
<td>YTD Q3 2019</td>
<td>$363 M</td>
<td>$1,015 M</td>
</tr>
<tr>
<td>YTD Q3 2020</td>
<td>$1,573 M</td>
<td>$10 M</td>
</tr>
</tbody>
</table>

Buy-Sell Outlook For The Remainder Of 2020 And Beyond

While we are technically in a recession, there are currently many buyers looking to acquire dealerships. They are willing to pay healthy prices for stores and lenders are also bullish and eager to lend to acquirers. There is less of a flight to quality in terms of franchises than in previous periods of economic distress since almost all franchises are making good money right now. We have seen healthy offers in all regions of the country.

We expect that the buy-sell market will continue to be highly active for the remainder of 2020 and into the first quarter of 2021. We expect that the impact of the 2020 election to be positive on the buy-sell market for reasons we will discuss later in this report. We can already feel an uptick in the number of dealers willing to sell now that the 2020 election results are becoming clearer.

It’s possible we could be entering into a more rapid phase of consolidation in our industry. Current dealership valuations are high, and some dealers are increasingly concerned that they may not possess the skills, information technology, and scale needed to compete with large groups in the future. These two factors could lead to an increase in the supply of dealerships for sale. And we know the demand is there for dealership acquisitions. Buyers can see several years of economic recovery in our future which provides them with potential upside in terms of dealership profits, and they are supported by lenders willing to extend significant credit at low-interest rates.
OVERVIEW

Blue Sky Values Increase For Most Brands

We carefully monitor the buy-sell market to assess the desirability of various auto franchises. We analyze offers for the transactions that we are involved in and regularly speak with leading buyers and many attorneys and CPAs who are involved in other acquisitions. When COVID arrived, it quickly had an impact on the buy-sell market. Some buyers pulled their offers, while others demanded price concessions. For those transactions that closed in Q2, we saw blue sky values fall about 10% from their levels at year end 2019. But as dealership profits rebounded, so did franchise values. Over the past 60 days, we have seen an increase in interest in buying dealerships and a willingness to pay more for them. While every transaction varies, we now estimate that most dealerships are about 10% more valuable today than they were at the end of 2019.

The table below provides our estimate of what multiples a motivated buyer participating in a competitive sales process (i.e., not the only buyer at the table) would be willing to pay for the blue sky of a franchise, in addition to the other dealership assets. In our Q1 2020 Haig Report, we had reduced the average estimated blue sky multiple for most franchises by 0.5x at the top and bottom of their ranges. Subsequently, our Q2 2020 Haig Report reflected an increase in the multiples for most franchises by 0.25x-0.5x given improved buy-sell activity and feedback from industry leaders. At current levels, blue sky multiples are an estimated 0.5x higher than year-end 2019 multiples at the top and the bottom of their ranges. The franchises on the right side of the graph are usually nominally profitable or lose money. We often see buyers put a dollar value on them since there are no earnings, and therefore a blue sky multiple is not applicable. Given the limited buyer appetite for these franchises, we have not seen their values increase from their values in Q2 2020.

The chart above is a guide for many dealerships. Still, buyers’ multiples or prices for dealerships will vary depending upon several factors and can be higher or lower than the ranges we indicate. The table below provides a list of some qualifying factors that could impact the value paid for a dealership.

FACTORs IMPACTING MULTIPLES

- Underperforming
- Metro Markets
- Rapid Growth Markets
- Low Tax Markets
- Low Real Estate Cost
- Geography Well Suited to Franchise
- Not Marketed Properly
- Facility Issues
- Rural Areas
- Slow/Negative Growth Markets
- High Tax Markets
- Add-Point Risk
- High Real Estate Cost
- Over-Dealered Markets

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TRENDS IMPACTING AUTO RETAIL

New Unit Sales Continue To Rebound As The Country Opens Up

Combined retail and fleet sales for the first nine months of the year have declined 19% from the same period last year. This decline comprises a fall in retail sales of 12.9% and 43.4% for fleet. The more significant drop in fleet came as rental car companies stopped buying vehicles as travelers stayed home, and municipalities also reduced their purchases.

The good news is that retail sales have begun rising again, up 3.0% compared with October 2019 when adjusted for selling days. For the rest of 2020, many experts are projecting continued growth in new vehicle sales compared to last year. Based on these projections, total new unit sales would be 15% less than what the industry sold in 2019, although retail sales will be down substantially less. Not a bad outcome given where we were in April of this year!

Source: JD Power
Changes In Sales For Individual Franchises

The following chart sets forth the change in new unit sales among the major franchises in YTD Q3 2020 compared to YTD Q3 2019. All franchises saw declining sales, with Mazda, Volvo, and Kia being the only franchises whose sales did not fall double digits. Both Nissan and Infiniti saw sales plummet more than 32%. Note, this data reflects changes in total sales per brand, including fleet sales, so the sales decline at dealerships is likely much less severe.

<table>
<thead>
<tr>
<th>Franchise</th>
<th>Change in Sales</th>
</tr>
</thead>
<tbody>
<tr>
<td>MAZDA</td>
<td>(2.3%)</td>
</tr>
<tr>
<td>VOLVO</td>
<td>(4.9%)</td>
</tr>
<tr>
<td>KIA</td>
<td>(7.6%)</td>
</tr>
<tr>
<td>PORSCHE</td>
<td>(11.8%)</td>
</tr>
<tr>
<td>MERCEDES-BENZ</td>
<td>(11.9%)</td>
</tr>
<tr>
<td>HYUNDAI/GENESIS</td>
<td>(12.8%)</td>
</tr>
<tr>
<td>LEXUS</td>
<td>(13.1%)</td>
</tr>
<tr>
<td>ACURA</td>
<td>(16.6%)</td>
</tr>
<tr>
<td>CHEVROLET</td>
<td>(16.8%)</td>
</tr>
<tr>
<td>VOLKSWAGEN</td>
<td>(16.9%)</td>
</tr>
<tr>
<td>SUBARU</td>
<td>(17.8%)</td>
</tr>
<tr>
<td>FORD</td>
<td>(18.3%)</td>
</tr>
<tr>
<td>BUICK/GMC</td>
<td>(18.4%)</td>
</tr>
<tr>
<td>AVERAGE CHANGE</td>
<td>(18.4%)</td>
</tr>
<tr>
<td>HONDA</td>
<td>(19.1%)</td>
</tr>
<tr>
<td>TOYOTA</td>
<td>(19.1%)</td>
</tr>
<tr>
<td>FCA</td>
<td>(20.4%)</td>
</tr>
<tr>
<td>AUDI</td>
<td>(20.7%)</td>
</tr>
<tr>
<td>LR/JAGUAR</td>
<td>(23.0%)</td>
</tr>
<tr>
<td>BMW</td>
<td>(24.1%)</td>
</tr>
<tr>
<td>CADILLAC</td>
<td>(25.2%)</td>
</tr>
<tr>
<td>INFINITI</td>
<td>(32.9%)</td>
</tr>
<tr>
<td>NISSAN</td>
<td>(37.6%)</td>
</tr>
</tbody>
</table>

Source: Automotive News (September 2020 Data)

GDP Is Recovering

The economy has been on quite the rollercoaster since the start of the pandemic. GDP has gone from the worst quarterly contraction in history during Q2 to the most robust quarterly growth in history at 33.1% for Q3. The Congressional Budget Office predicts GDP will be 5.1% lower than it was in 2019 but will grow in 2021 by 4.8%. Many economists also agree that it will take till early 2022 before our economy returns to 2019 levels. If these predictions are correct, the pandemic will be more severe in magnitude yet shorter than the Great Recession.

Unemployment Continues To Drop

The unemployment rate has steadily improved since it spiked to 14.7% in April. According to the U.S. Bureau of Labor Statistics, total nonfarm payroll employment rose by 638,000 in October, and the unemployment rate declined to 6.9%. These improvements in the labor market reflect the continued resumption of economic activity curtailed due to the pandemic and efforts to contain it. In October, notable job gains occurred in leisure and hospitality, retail trade, construction, transportation, and professional and business services. However, we still have a long way to go as overall employment is down by almost 11 million jobs since February.

Fuel Prices Remain Low

The national average price per gallon of gas at the pump was $2.15 at the end of October 2020, 19% below the level at the same time last year. These low gas prices can be beneficial to dealers as consumers have more discretionary income to make auto purchases. Fuel prices will likely continue to be low for the near future as demand remains depressed worldwide due to the pandemic.
Miles Driven Fell, But Is Now Rebounding

The number of miles driven on an annual basis is a crucial driver for our industry as it heavily influences the replacement rate for vehicles and spending on fixed operations. More miles driven equals a greater need for vehicles, parts and repairs. As people stayed home due to the pandemic, travel on all roads and streets plummeted 41.4% in April 2020 compared to April 2019. Travel has increased 50% from April to September as some have returned to the office and school, but we are still driving a lot less than we used to. US residents drove 9% fewer miles in September 2020 than in September 2019. There are a few offsetting trends at work here that determine the number of miles driven. Much of the country will continue working from home, which would imply less driving, but there has also been a move away from public transportation and ride-sharing which would point to more driving. A vaccine could have a big impact here, making people feel more comfortable driving to work and school and hoping to boost employment.

Interest Rates Will Continue To Remain Near Zero

The Federal discount rate has been hovering at just 0.25% and the Federal Reserve has vowed for it to remain at this level for years to come. Low-interest rates help to stimulate auto purchases and leases since they reduce the monthly payments for consumers. According to Edmunds, the average interest rate for a new-vehicle loan is currently hovering around 4.6% in Q3 2020, compared to 5.7% in Q3 of 2019. Low rates will also continue to boost dealer profits by reducing floorplan expenses and mortgage payments. In fact, in this current environment of rapid turnover of inventory, dealers who own franchises that provide floorplan credits are likely generating hundreds of dollars of profits per unit retailed since the cars are moving so quickly.

Consumer Confidence Is Rising, But Uncertainty Remains

The Consumer Confidence Index plummeted from a near historic high of 101.0 in February 2020 to 71.8 in April 2020. After nearly six months of fluctuation, the index reached 81.8 in October 2020. Two major concerns continue to linger on the minds of many consumers: a rebound of COVID and the “hyper-partisanship” seen during the election and months leading up to it. We expect next month’s results will show another increase due to the announcement of the Pfizer and Moderna vaccines and that the results of the 2020 election will largely be settled.
Used Vehicle Values Continue To Be Elevated

The used vehicle market has puzzled dealers and analysts since April when prices hit bottom. During the last six months, prices have been regaining ground at a much faster pace than anticipated. The ongoing lack of new vehicle supply has increased demand for used vehicles. Dealers are looking to increase their used business to compensate for the lack of new products to sell. There are also aggressive new buyers in the market like Carvana and Vroom that are making strong bids for used units. Wholesale used vehicle prices have been climbing ever since and now stand 16% over where they were in October 2019, according to Manheim’s Used Vehicle Value Index, setting a new record high level.

Dealers Are Increasingly Focused On The Used Vehicle Market

Since the supply of new vehicles fell sharply earlier this year, dealers have increasingly focused on selling more used vehicles. Used vehicles have become an attractive alternative to new vehicles for many consumers since the mix of trucks and CUVs/SUVs available at dealers’ lots now closely matches consumer demand, and prices can be much lower. There is still plenty of room for higher used vehicle sales at franchised dealerships since they account for around 30% of total used sales. Per NADA, privately owned franchised dealers owned had a used-to-new ratio of 0.93:1.0 for LTM September 2020. This ratio is up substantially from the 0.85:1.0 average in 2019. We expect this ratio to continue to grow as new inventory is supply-constrained, and the lower prices of used vehicles remain a draw for budget-minded consumers.
New Vehicle Grosses At All-Time Highs

Gross profits per new vehicle jumped an amazing $858 on average in Q3 2020 for the public retailers compared to Q3 2019. The demand for new vehicles outstripped supply as production at OEMs and parts suppliers remain hampered by COVID. A question many in the industry are asking is, how long can this continue? History may provide us some guidance. The Japanese tsunami and Thai floods of 2011 created the last supply shock in auto retail. Production dropped most for Toyota, Honda, and Ford. During that period, almost all dealers compensated for the lack of inventory by raising prices. Production, however, returned within a few months and dealers saw their new vehicle gross profits per vehicle fall back to pre-flood levels within less than a year. We are expecting the same rebound in production will happen again in the US, although the timing is uncertain as COVID is surging again in the US so factories will have a hard time staying in full production. Until COVID is brought under control we may continue to see elevated gross profits due to product shortages.

Source: SEC filings

Used Vehicle Grosses Have Spiked

An elevated demand for used vehicles, coupled with a lack of new vehicle inventory, has provided dealers with significant pricing power in the market today. The public retailers reported a whopping $614 increase in profit per used unit in Q3 2020 compared to Q3 2019. It's likely that these elevated profits will also decline as new vehicle production returns to more normal levels. In the meantime, dealers are enjoying their good fortunes.
Finance & Insurance Departments Are Generating Record Profits

F&I profits per vehicle continue to increase as transaction values go up and retailers do a better job on product penetration. The public companies earned $1,742 per vehicle retailed in F&I gross profit in Q3 2020, up an impressive $170 (10.8%) from Q3 2019. AutoNation has set the pace for the rest of the publics, generating F&I income of $2,154 per vehicle retailed. Private dealers also enjoy substantial profits made through reinsurance companies that do not run through dealer statements. For instance, one dealer we are working with now has over $15M in his reinsurance accounts for just two Japanese import stores, and much of this will become profit.
TRENDS IMPACTING AUTO RETAIL

Combined Front And Back Gross Profits Per Vehicle Retailed Hit All-Time Highs

The tables below track combined front and back end profits per vehicle retailed data back to 2010. Thanks to gains in front-end and back end gross profits, dealers are enjoying record high profits for each vehicle they sold in Q3 2020.

PUBLIC COMPANY VEHICLE GROSS + F&I PVR

Weighted Average Same Store Performance - In Current Dollars

Note: Front end gross profit includes manufacturer incentives and other income.
Source: SEC filings; F&I as reported for new and used combined

Fixed Operations Are Beginning To Rebound

Perhaps the biggest source of suffering for dealers from COVID has been in their fixed operations. After a decade of steady increases, people are driving less due to the pandemic so dealers have seen decreased demand for maintenance, repairs, and parts. According to NADA, fixed operations fell 11.7% for the average dealer through September 2020 compared to the same period in 2019. That’s about a full month of productivity, so about what should be expected due to the closings that happened in March and April. We have heard from some dealers that their fixed operations have returned to pre-COVID levels in Q3, which is an encouraging trend that we hope will continue. But we are also hearing concerns that the OEMs are having parts shortages due to plant closures that will limit dealers’ ability to perform service work in the short term.
Dealerships Have Reduced Expenses

When the pandemic hit and many dealerships were forced to close, dealers reacted by paring their outlays as much as possible. Even as demand rebounded, dealers have been careful to watch their expenses. Dealers have discovered they can serve their customers with fewer employees and fewer vendors, resulting in a drop of 6.9% in SG&A (16% of gross).

Advertising expenses are down 19.8% YoY (1% of gross) as dealers spend a larger percentage of advertising dollars on digital and feel less need to spend heavily given limited inventory. Floorplan interest is down $266 per car, coinciding with an overall drop in inventory and historically low-interest rates. As a result, expenses decreased as a percentage of gross profit from 82.7% in January-September 2019 to 78.6% in January-September 2020. It will be interesting to see if dealers can remain this lean as volumes recover in 2021. As stated on this page, the reduction in floorplan expense has been much welcomed by dealers. Net average floorplan expense per vehicle retailed decreased from $185 for January-September in 2019 to income of $81 for the same period in 2020. The future looks even better for dealers. If we look at just the month of September, we see that floorplan expense flipped from a $62 expense in September 2019 to a $318 credit in September 2020. These credits should continue as long as we have low rates and low days supply.
Dealership Profits Are Breaking Records

The net outcome of the trends listed above is that average profits at privately owned dealerships increased 19.7% through September 2020 compared to the same period in 2019. These are record-high levels and dealers are thrilled with the rapid turnaround of their businesses. The table below shows the annual earnings at privately owned dealerships since 2010. We spoke with one large dealer group who has exceeded their 2019 full year income by October 2020.

When we look at the recent profits per month per dealer as shown in the chart below we were astounded to see that profits per store were almost double in June-September 2020 compared to the same months in 2019. While store-level profits peaked in August, September 2020 was still 71% higher than September 2019. It appears to us that profits will remain elevated for some time. One important note: we do not believe that dealers have converted any of their PPP funds into income at this point. Our CPA friends tell us most dealers will take PPP loans into income in Q1 and Q2 of 2021 when the government begins to forgive the loans.
Public Dealership Values Have Soared Since The Pandemic Hit

The share prices of the six public franchised retailers declined sharply in March 2020 as investors became concerned about the impact of COVID-19. But prices have increased sharply as investors heard about strong sales, high margins and lower expenses. At the time of the publication of this report, the average stock price for the public retailers was 40% higher than the beginning of the year. The S&P 500 Index is up only 10% during this time. This is an amazing turnaround based mainly on investors’ excitement about the auto retail business model that has proven to be highly flexible and resilient to almost any economic shock that exists. Investors are seeing that the public companies are generating large amounts of profit even with a lower SAAR thanks to higher gross profits per vehicle, reduced personnel expenses, a bigger focus on used vehicle sales, low floor plan rates and the possibility that technology will help these larger groups take share from smaller dealers. None of the public retailers took PPP loans so their profits are solely derived from operations. Lithia is driving a big part of the increase in the average stock price partly due to its growth strategy that we described in our Q2 2020 Haig Report. The chart below shows how the franchised retailers have performed compared to the used retailers (CarMax and Carvana) and the S&P 500. Note that the used retailers have outperformed thanks largely due to Carvana’s explosion in market value to over $38B at the time of this writing – more than all the franchised retailers combined.

Real Estate Values Are Stable

From 2010-2019 we saw dealership real estate values steadily rise. Escalating values helped transactions come together since the appraisals we obtained on our client’s real estate before going to market were met or exceeded by the appraisals that buyers obtained when they went for financing. Buyers, sellers and lenders were all happy.

In our Q2 2020 Haig Report, however, we wrote that a couple of buyer-requested appraisals had come in 5%-10% below the pre-pandemic appraisals our clients had obtained on their dealership real estate. That concerned us since virtually no dealership real estate had sold in this interim period. We felt that appraisal firms were essentially assuming there was a decline so they were, in effect, creating the decline. But we are pleased to say that the buyer requested appraisals that we have seen most recently largely mirror the seller requested appraisals that were conducted a few months ago. Appraisers appear to have realized that dealerships are performing well, they are able to support healthy rent factors, and that buyers are eager to purchase real estate at prices that equal 2019 levels.
Transaction Volume Is Recovering

The buy-sell market came to a sharp halt in April as buyers became concerned about the economy and how dealerships would fare during the pandemic. The pace of 25-30 dealerships trading hands each month shrank to just a handful. Through the first six months of 2020, dealers had purchased 15% fewer dealerships than in the first six months of 2019. In Q3 2020, however, we saw the acquisition pace exceed normal conditions as 95 stores changes hands, compared to 87 in Q3 2019. This puts the number of dealerships sold through the end of Q3 2020 to be 7% below the same period of last year. But given all the recent activity announced so far in Q4 2020, we could see this gap narrow by the end of the year.

In our Q2 2020 Haig Report, we discussed Lithia’s plan to acquire $20B of revenue over a five-year period. To reach its goals, Lithia will need to continue to invest large amounts over the next few years. We also believe that Lithia’s aggressive growth plans will put pressure on the other publicly-traded retailers to increase their level of acquisitions. And we have a newly formed public company, LMP Automotive Holdings, that has announced its plans for rapid growth, including the acquisition of a majority stake in Staluppi Auto Group for over $400M. When you consider what Lithia plans to spend, plus what the other five, now six, publicly-traded retailers could invest, it’s exciting to see that we appear to be entering a unique period in the history of our industry. There could be more money spent on acquisitions in the next five years than we have seen in the past decade.

Potential Impact Of The 2020 Election And GA Senate Run–Offs On The Buy–Sell Market

At the time of this writing, the results of the 2020 Presidential election were being litigated. What might be more important to the buy-sell market, however, is the situation in the Senate. If GA re-elects one or more of the incumbent Republican senators then it seems highly unlikely that personal or capital gains taxes would increase by any material amount. A substantial increase to personal and corporate taxes would mean buyers would have less capital for acquisitions as they would be paying more of their income to the government. This could reduce demand for dealerships. And a significant increase in the capital gains rate could push dealers to delay the sales of their dealerships since their after-tax proceeds would be reduced, thereby shrinking the supply of dealerships for sale. And even if both Democratic senate candidates should prevail, it would still be difficult for Congress to pass large tax increases since that would require all 50 Democratic senators to vote to raise taxes by a material amount, which seems unlikely, since a good number of them will be facing reelection in 2022. Given these factors, many experts we have spoken to believe that the current tax rates will remain in place for the next two years.

Record High Spending By The Public Retailers

The amount of money spent by the publicly traded auto retailers exploded in Q2 and Q3 and is now at record levels (in the midst of the pandemic!). Due primarily to Asbury and Lithia, the public retailers spent almost $16B on acquisitions of auto dealerships in the US during the first nine months of 2020. This amount exceeds the most spent by public auto retailers during any full year, to our records. And there is more to come. In Q4, Lithia acquired a large group in California and we expect it will make other acquisition announcements in the upcoming weeks. We could be over $2.5B in spending by the end of the year.

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The Current Perspectives Of Buyers And Sellers

We have been speaking with many leading dealership groups, attorneys who conduct buy-sell work, lenders who provide capital for acquisitions, and CPAs who provide due diligence and closing services for buy-sells.

The buyer’s perspective:

• They are thrilled with their dealerships’ performance and expect good times will continue for the next few months, but then return to “normal” sometime later in 2021
• They have a lot of cash on their balance sheets and want to invest it
• They are open to almost every brand
• They are willing to pay more for dealerships than at the end of 2019, but not a lot more

The seller’s perspective:

• Their high profits are giving them leverage in terms of pricing. We saw bidding wars in the last four transactions we were involved in
• They are more relaxed now that the election results indicate taxes will remain low for them in 2021
• They are increasingly concerned about their ability to compete with larger groups who have greater access to the talent, breadth of inventory, capital, technology and consumer focus. Some have the sense that a game of musical chairs has begun. They want to make sure they have a seat (a sale) before the music stops (competitors erode the value of their business)

Private Dealership Values Are Near All-Time High Levels

Many factors drive the blue sky value of dealerships. A buyer’s expectations of future profits are important, as are interest rates, the amount of debt a buyer can deploy, and tax rates. At this point in time, all of those variables are working in combination to increase the value of dealerships to be close to the highest levels we have ever seen.

Let’s start first with a buyer’s expectations of future profits. For the past several years we have enjoyed annual sales of over 17M new units and average dealership profits between $14M and $15M - remarkably consistent. Due to the pandemic, pent up demand and stimulus dollars, many dealers are enjoying record-high levels of income. Dealers know these record profits are not sustainable, but they have shown they can generate high levels of profits even with lower sales volumes due to lower expenses, lower floorplan rates, and a greater focus on used cars. Based on our conversations with buyers, we believe many are using sellers’ 2019 results as a floor of what profits could be in 2021 and beyond.

Lenders have told us that they are also bullish about the future. Some are using 2019 profits as a basis for how much debt they will provide in an acquisition, but a few have told us they are using current profits as the best judge for the future. When a dealer can finance more of an acquisition with debt then the return on investment increases and the dealer can pay more for dealerships.

Next, interest rates are lower today than they were at this point last year. Lower rates increase cash flows and therefore the returns on investment from acquisitions. Dealers can pay more for dealerships.

Finally, income taxes are likely to remain low for at least the next two years. Low income taxes provide more after-tax cash flow to buyers which helps them to service debt and improves their returns on investment from acquisitions. Low taxes also encourage dealers to offer more for acquisitions.

In our Year-End 2019 Haig Report, we estimated the blue sky value for the average dealership in the US to be $6.7M, based upon an average blue sky multiple of 4.8x and average pre-tax profit of $1.4M. We now estimate that the average blue sky value per store has increased 10% from Year-End 2019 to $7.4M. Some may ask if the blue sky multiple increased or did buyers calculate higher earnings in their offer? Our belief is that buyers may debate which variables they are using, but they agree that stores are worth more today than they were before the pandemic.

At our estimate of $7.4M in goodwill value, dealerships are trading for 5.2x 2019 Year-End Profits or 4.5x pre-tax profit for the twelve-month period that ended 9/30/2020. Some buyers will average a seller’s last three years of earnings as an estimate for future profits. Using this formula, our estimate is that dealerships are trading for an average of 5.0x the average pre-tax profit of $15M.
The Outlook For Buy-Sells For The Remainder Of 2020 And 2021

We expect buy-sell activity to continue to accelerate for the balance of the year and into 2021. Profits are likely to remain high, debt will remain cheap, and there are many groups looking to grow. For those groups with talent, technology, scale and capital we believe they will enjoy excellent returns on their acquisitions. We also believe that other dealers will see the next two years as an opportunity to exit at high prices and with low tax rates. A number of these dealers have told us they are increasingly concerned about their ability to compete with larger groups. They see that it’s possible that the value of their businesses will erode even if the overall market is strong. These dealers will provide a steady supply of acquisition opportunities to the market.

FRANCHISE VALUATION RANGES

We have been involved in the purchase and sale of 380+ dealerships in our careers dating back to 1996. 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. COVID-19, the economic shutdown, and the rapid recovery are certainly playing a role in dealership valuations today and we have factored its influence into our estimates.

LUXURY FRANCHISE BLUE SKY MULTIPLES

**Porsche**
Porsche sales are moving in the right direction, up 5% in Q3 2020 relative to Q3 last year, although still down on the year due to the COVID shutdowns. The Macan continues to be the sales leader. Dealers are also excited about their newest product, the all-electric Taycan which is outselling other Porsche cars. Thanks to their scarcity, high profits, and ease of operation, Porsche continues to bring the highest blue sky multiples of any franchise other than Ferrari. **Higher multiple range on 2019 adjusted pre-tax profit: 9.0x–10.0x.**

**Mercedes-Benz**
Mercedes-Benz sales decreased 5% in Q3 2020 compared to Q3 2019, narrowing the decline it experienced in the first half of the year. The brand continues to recover from inventory shortages due to manufacturing shutdowns triggered by the pandemic. Mercedes is well positioned with a new compact crossover, the GLB, as well as the refreshed GLA, to tap into the shift away from sedans. Dealers are happy with the products and US management. Dealer profits remain among the highest of any franchise. Buyers are highly interested in the brand. **Higher multiple range on 2019 adjusted pre-tax profit: 7.5x–9.0x.**
Lexus

Third-quarter sales at Lexus were up 2% as Lexus weathered the pandemic better than its counterparts and is on the way to take the luxury sales crown for the first time in years. Lexus saw a 3% jump in deliveries in September led by its RX and NX crossovers and ES sedan. Consumers love the quality, high resale value, and cheap leasing options. Dealers are also pleased with the high margins they are seeing during this pandemic era, plus strong used car and fixed operations. Lexus dealer profits are now above those of the German luxury brands. Dealers ranked Lexus and Toyota as their top brands in a recent NADA survey. We are seeing very strong demand for this franchise. Higher multiple range on 2019 adjusted pre-tax profit: 8.0x–10.0x.

BMW

Sales fell 16.2% in the third quarter of 2020 compared to the same period last year, far worse than its competitors. BMW was having a harder time getting production back on-line. There is no lack of demand for their products as dealers tell us margins have exploded during this period of limited inventory. Shortages may be ending as September's shipments of vehicles drove record monthly sales. Dealers also tell us BMW is working to revise its service loaner program which could result in lower costs and higher margins for new vehicles for dealers. Higher multiple range on 2019 adjusted pre-tax profit: 7.5x–9.0x.

Audi

Audi sales are down 16% in the third quarter of 2020 compared to Q3 2019. The brand achieved its best third quarter ever in terms of CPO deliveries, up 26% year-over-year. Customers love the products, but the brand still falls short of its luxury competitors in terms of retail margins (due to difficulty attaining the incentive structure), costly facility expenses, and expensive loaner programs. As a result, these dealerships sell for slightly lower multiples than other premium luxury brands. Higher multiple range on 2019 adjusted pre-tax profit: 6.25x–7.25x.

Jaguar / Land Rover

JLR saw unit sales declines of 23.6% and 22.5% respectively in the third quarter of 2020 compared to the same period last year. The company is having a tough time recovering from the damaging effects of the pandemic which has ended its chances of continuing its ten consecutive years of growth in combined sales. That said, dealers tell us their business remains very strong with excellent margins on new and used and strong fixed operations. We recently visited a JLR dealership and saw the new Defender on the showroom, along with a $35K addendum to the sticker for dealer add-ons. With margins like this, JLR dealers enjoy some of the highest profits per store in the industry. Despite these kinds of eye-popping margins, JLR trades at a lower range than most luxury brands due to its expensive facilities, the drag of J LR, and incoming add points. Higher multiple range on 2019 adjusted pre-tax profit: 6.25x–7.25x.

Volvo

Volvo maintained its upward sales trend announcing its fourth consecutive month of year-over-year growth. Retailing 12,274 cars in September 2020, the strong result represents a 12.2% growth over the same period last year and marks the best September since 2004. We are seeing higher demand for these dealerships that have the potential for significant growth in profitability if volumes can further increase. Higher multiple range on 2019 adjusted pre-tax profit: 4.0x–5.0x.

Acura

Acura’s sales rose 16% in the third quarter of 2020 compared to the same period in 2019. Acura has seen a turnaround due to a fresh lineup of performance-focused models. September sales increased 3.6% month over month on strong sales for MDX, RLX, and ILX models. Still, Acura remains in a low volume—low gross category compared to its premium luxury peers which means that the profits per franchise are much lower, and therefore reduces the desirability of the brand. Higher multiple range on 2019 adjusted pre-tax profit: 3.0x–4.0x.

Infiniti

Infiniti sales fell 30.2% in the third quarter of 2020 compared to the same period in 2019, the worst performance of any brand we track. The brand is suffering from an aging product lineup and management turmoil. Most dealers are no longer chasing volume targets and are more focused on used cars. The pandemic could be a blessing to many Infiniti dealers, allowing them to sell aged inventory. Profits per store are likely the lowest for any major franchise. Key new products are coming in 2021 which could help Infiniti to rebound from this point, possibly the lowest position since the brand was launched in the 1990s. Dealers ranked Infiniti third from the bottom only above Fiat and Jaguar in a recent NADA survey. Same value range: $0–$1,500,000.

Cadillac

Cadillac saw sales decrease by 17.5% in the third quarter of 2020 compared to the same period last year. Prior to the pandemic, Cadillac was planning to launch a new product every six months for over two years to try to restore the brand to higher relevance. The new Escalade has added lots of luxury features and can now exceed $100K. We have recently heard about two recent changes at this brand. First, Cadillac dealers will be required to add electric vehicle charging stations at the dealerships which will cost roughly $150K per store. And second, Cadillac is reportedly offering dealers several hundred thousand dollars for small to mid-size stores in return for dealers terminating their franchises. If accurate, these would be meaningful incentives for smaller dealers to exit. Rather than writing a big check, they could cash one. The results could be highly beneficial for the remaining dealers who suffer from low throughput and low margins due to overdealering. Same value range: $0–$1,500,000.

Lincoln

Lincoln sales were down 14% in the third quarter of 2020 compared to the same period in 2019. As Lincoln focuses on the luxury SUV market they are gaining market share. Dealers are irritated that Lincoln is pushing free-standing, costly facilities. There is not enough volume and gross profit per Lincoln franchise today to support many of these facilities. With the discontinuation of the Lincoln MKZ, the brand's lineup now only includes SUVs. Low volumes and high facility costs limit the appeal of the brand. Same value range: $0–$1,500,000.
**MID-LINE IMPORT FRANCHISE BLUE SKY MULTIPLES**

**Toyota**

Toyota announced an 11% sales decrease in the third quarter of 2020 compared to the same period last year due to limited supply. Sales jumped 12% in September as shipments rebounded to normal levels. Dealers are excited about the products and US management. They feel like Toyota as is as strong as it ever has been. Dealers ranked Lexus and Toyota as their top brands in a recent NADA survey. We are selling several Toyota dealerships currently and we saw intense interest from many buyers. Dealers believe Toyota/Lexus is the best OEM partner so dealership values are strong. Higher multiple range on 2019 adjusted pre-tax profit: 6.0x–7.0x.

**Honda**

Honda sales were down 9.5% in the third quarter of 2020 compared to the same period last year, in line with the industry overall. September sales marked the first sales gain since the pandemic began. Honda got a lift from strong demand for its CUVs, including the CR-V compact and mid-sized Passport models. The Civic remains the top-selling car in the U.S. through September and forecasts to remain the leader in its segment for the fifth straight year. Some dealers are concerned about management turnover at Honda US, but demand for these dealerships remains high as dealers continue to enjoy consistent, strong profits. Dealers ranked Honda just behind Toyota and Subaru as their favorite for non-luxury brands. Higher multiple range on 2019 adjusted pre-tax profit: 6.0x–7.0x.

**Subaru**

Subaru sales decreased by 8.8% for the third quarter of 2020 compared to the same period last year. But, thanks to a rebound in production, Subaru recently reported its best September ever and highest sales month of 2020. Brand loyalty remains extremely high and dealers speak highly of the US management team. Dealers ranked Subaru just behind Toyota in a recent NADA survey. We have been involved in the sale of several Subaru stores recently and demand was high from existing dealers and those hoping to break into the network. Higher multiple range on 2019 adjusted pre-tax profit: 6.0x–7.0x.

**VW**

Volkswagen saw sales decrease by 7.6% in the third quarter of 2020 compared to Q3 2019, far better than most brands. Its CUVs are faring well. Volkswagen is moving quickly toward electrification of most of its vehicles which could work out well if the market starts to move in that direction, but also puts VW at risk if consumers continue to prefer internal combustion engines. VW stores continue to be low volume although during the pandemic era dealers are enjoying decent gross profits on new units. Higher multiple range on 2019 adjusted pre-tax profit: 6.0x–7.0x.

**Hyundai**

Sales decreased by 17% in Q3 2020 compared to the same period last year. Hyundai has kept itself in a good position and seen another month of market share gain thanks to stable inventory and well-received consumer incentives. The brand is propelled by a robust CUV lineup, including the full-sized Palisade which dealers struggle to keep in stock. Dealers are wary of potential changes and dislike the push for updated facilities, but still rank Hyundai as the fifth most preferred non-luxury franchise, just after Kia. Higher multiple range on 2019 adjusted pre-tax profit: 3.25x–4.25x.

**Mazda**

Mazda sales were up 6.9% in Q3 2020 compared to the same period in 2019, making it one of the best-performing franchises. Mazda also saw a significant uptick in its September sales, closing the month almost 30% ahead of last year on strong sales of its CUVs and a solid contribution from its sedan lineup. The construction of a plant in Alabama in conjunction with Toyota will increase production capacity by up to 100,000 units. Mazda dealers can benefit from high gross profit margins and hefty factory incentives on new units by hitting target metrics. Mazda’s new image requirements bother some dealers and some potential buyers do not see the cost being worth the benefit. Higher multiple range on 2019 adjusted pre-tax profit: 3.0x–4.0x.

**Nissan**

Nissan reported a 32.4% decline in Q3 2020 compared to Q3 2019. The brand has been declining since 2017, perhaps returning to a level of market share that was more appropriate to its competition. However, the pandemic has led to a spike in dealership profits as dealers are able to retail units for healthy grosses and are spending less money chasing money-losing deals to hit stair-step incentives. More good news is coming from an onslaught of new core products that should allow Nissan dealers to compete nicely in its segment. Nissan management is saying they are focused on dealer profits as a key part of its own future success. Between a change in management and the new products, we believe Nissan stores are poised to grow their profits sharply over the next year or two. We believe the worst is behind Nissan and some dealers will be looking to pick up these franchises for far less than what it would cost to purchase a competing franchise. Higher multiple range on 2019 adjusted pre-tax profit: 3.0x–4.0x.

**DOMESTIC FRANCHISE BLUE SKY MULTIPLES**

**Ford**

Ford sales were down 4.9% in the third quarter of 2020 compared to the same period last year. Ford performed far better than the market on the strength of its trucks and SUVs. Ford also began reporting monthly sales again in October with a 6.3% decline driven by discontinued car models, a changeover to the next-gen F-150, and drastically lower fleet sales. SUVs were up 8.9%. Dealers and consumers alike are excited about upcoming products such as the redesigned Bronco, the new 2021 F-150 (with an electric version) and the all-electric Mustang Mach-E. Newly appointed CEO, Jim Farley, looks to turn around recent struggles by improving vehicle quality, product launches (all eyes on F-150), reducing costs, and
accelerating the restructuring of underperforming businesses. He may also be taking the franchise more in the direction of commercial vehicles, which could allow dealers to gain higher profits. A leading Ford dealer told me that Farley has restored confidence to the brand amongst dealers, saying “It was like a light switch went on.” Ford’s Q3 profit was a staggering $2.38B. **Higher multiple range on 2019 adjusted pre-tax profit: 3.5x–4.5x.**

**Chevrolet**

Chevrolet saw sales drop by 12% in the third quarter of 2020 compared to the same period in 2019. More than any other franchise, dealers are complaining about the difficulty of getting new Chevrolet inventory. GM had an estimated 52 days supply in October, down from 83 days in October 2019 which was already low due to the 2019 strike. Lineup changes include the all-new Tahoe and Suburban (finally with independent rear suspension!) and hopefully more Corvette production. The Impala and Sonic are discontinued. An electric crossover, van and pickup are expected to join the Bolt over the next few years. Despite, or perhaps because, of the lack of inventory, dealers are making lots of money at their Chevy stores. One large group told us their Chevy stores are making $3M per month, more than their German luxury stores. Dealers can do very well with this brand in markets that are not overdealered since they can generate healthy grosses on new and used units and fixed operations are strong. **Higher multiple range on 2019 adjusted pre-tax profit: 3.5x–4.5x.**

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

FCA enjoyed a sales increase of 13% in Q3 2020 compared to last year. The company cited robust retail demand and increased vehicle transaction prices as having compensated for less than expected fleet sales. The RAM brand remained a powerhouse as dealers saw a 15% uptick in sales of pickup trucks. Jeep also posted a solid quarter, led by the continued success of the Jeep Gladiator and Jeep Wrangler. RAM and Jeep were the highest rated Big 3 brands in the most recent NADA index ranking. These dealerships can offer healthy profits in areas where they are not overdealered. FCA is pushing dealers hard to carve out a separate showroom for Jeep. It remains to be seen if stores will generate the incremental gross profit to pay for the higher facility expense. **Higher multiple range on 2019 adjusted pre-tax profit: 3.5x–4.5x.**

**Buick-GMC**

Buick-GMC saw a 5.0% decline in sales in Q3 2020 as compared to the same period last year. Dealers have the same complaints about lack of supply with GMC as with Chevrolet, but are excited about the new Yukons and Denalis. Buick is now all CUVs, a remarkable evolution from a brand synonymous with sedans and coupes. GMC has been generating a lot of excitement with the new all-electric Hummer pickup, which will likely also be offered in an SUV version. We are glad to see GM finally capitalizing on this brand as it could help to further differentiate GMC and Chevrolet products. **Higher multiple range on 2019 adjusted pre-tax profit: 3.25x–4.25x.**

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**FRANCHISE VALUATION RANGES**

**Higher Prices**

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

**Experience**

Since we have been involved in more than 180 transactions for over 380 dealerships with over $5.5 billion in value, we know how to respond to issues that can arise in a buy-sell process.

**Relationships with Buyers**

We know and are respected by many of the best buyers across the US. We understand what they want to acquire and how they negotiate. By targeting specific buyers instead of running ads, we preserve confidentiality and close transactions more efficiently.

**Speed**

We focus on the transaction every day, allowing our clients to focus on dealership operations.
Although COVID continues to disrupt our lives, auto dealers have done a remarkable job adjusting to the conditions. They cut expenses as their volumes dropped, made purchasing and servicing vehicles more convenient to customers, and adjusted pricing for new and used units as supplies tightened. The result is that auto dealers are enjoying record high levels of profits, which is a remarkable turnaround from April when dealers were wondering about the future. While we expect margins will return to lower levels as supply returns, we also expect that dealers will retain some of the benefits of this period.

Another surprise was that COVID did not derail the ambitious expansion plans of Lithia and a number of privately owned dealership groups. They shrugged off the short-term pain from the pandemic and are now accelerating their growth. We expect other groups will follow their leads and add to their dealership counts, providing healthy demand that will support dealership values.

We also are aware of a number of dealers becoming concerned about the future. They wonder about their ability to compete with groups that have more capital, bigger inventories, greater knowledge of technology, and a deeper pool of management talent. These are some of the dealers that we are seeing coming to market now, even those not at retirement age. They want to secure current prices rather than take a risk at declining profits in the future that could erode their values.

The result of these various trends is that dealership values have increased and we are seeing more buy-sell activity. We expect these robust conditions to continue well into 2021. Our firm has sold over 31 dealerships to date which is a record for us, with more closings coming up soon. We are expecting even more activity in 2021.

Having been involved in over 190 transactions for more than 380 dealerships, no other firm has a better understanding of the perspectives of both buyers and sellers of dealerships across the U.S. We use this expertise to create highly informative and compelling offering materials that help buyers to focus on our clients instead of other opportunities. We listen to our clients to create a customized marketing process that carefully balances their priorities of maximizing price, preserving confidentiality, and time to closing. Through our unmatched expertise, deep relationships with buyers, and well-honed processes, Haig Partners is able to produce highly desirable outcomes for our clients.
Contact Us Today To Learn More About Your Dealership’s Potential Value

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