

BUY-SELL Q&A DEALERSHIP VALUATION TRENDS

The retail auto industry is enjoying the best buy-sell market in decades, driven by dealerships posting unprecedented profits and earning record-high valuations. What does this mean going forward for dealership buyers and sellers? Industry expert Alan Haig, president of Haig Partners, shares his perspectives on this tumultuous yet exhilarating post-pandemic buying-selling spree.

Q: What impact has the pandemic had on the value of dealerships?

A: The pandemic has had a very positive effect on the value of most dealerships. Shortly after the initial shock in March and April, dealership profits began to soar thanks to strong demand and lower costs. Buyers responded by wanting more dealerships and have been willing to pay higher prices. In our Q1 Haig Report, we estimate that the value of an average dealership has increased 33% since the end of 2019, just before the pandemic hit. In fact, we estimate the blue-sky value for dealerships is the highest it's been since I began buying dealerships in 1996. We are at record-high levels.

Q: We saw a huge surge in dealerships changing hands in the fourth quarter of last year, and a steady rise in prices as well. Has that buy-sell boom continued in the first half of 2021? Are we on track for a record year?

A: The buy-sell market remains very active. We saw a 46% increase in dealerships sold in Q1 2021 compared to Q1 2020. The second quarter appears to be just as busy. Our firm has already had 12 closings so far this year, which is about what we had in all of 2020. While we know surprises like the pandemic can always occur, we are currently poised for one of the busiest periods for buy-sells since the late 1990s. That was the era when my team and I were buying hundreds of dealerships to create the foundation for AutoNation at the same time that the other public companies were also growing quickly. Consolidation is accelerating again.

Q: And what about the average blue-sky value? Will we see a record there in 2021? And what is driving the continued growth in valuations?

A: We estimate that the average blue-sky value for a dealership reached \$9.0 M in Q1 2021, the highest we have ever recorded, and 33% higher than at the end of 2019, before the pandemic hit. The biggest driver in higher values is higher profits, and it's possible



Alan Haig

blue-sky values are still going up since earnings are still going up. Another driver of higher values is increased demand. There are lots of dealers that find themselves with more cash to invest than in the past, thanks to huge profits at their stores, plus Paycheck Protection Program (PPP) loan forgiveness.

Q: How are the market pressures on new-car inventory affecting dealership valuations?

A: The shortage of new vehicle inventory has led to higher new vehicle gross profits and lower advertising and floorplan expenses. The lack of new vehicle supply might be the biggest driver of higher profits at dealerships, and therefore the biggest driver of higher blue-sky values. We believe new vehicle inventories won't be fully corrected until next year. Until then we expect dealership valuations to remain elevated.

Q: What are some of the biggest factors impacting a store's valuation these days, in a practically post-pandemic environment?

A: Higher profit is one of the biggest drivers of higher valuations today. We expect dealers will enjoy elevated profits for many more months to come. And when production returns, we think we will see a lift in sales to satisfy the pent-up demand that is being created. Strong demand is another key factor in higher dealership values. The public companies are all out competing to buy dealerships. Their investors want to see them grow during this period of economic expansion. And thanks to low interest rates and high stock prices, the public companies have very inexpensive capital, which means that acquisitions are highly accretive to their stock prices. And private buyers are also active. They are less concerned about risks like ride-sharing, autonomous vehicles or a recession. Buyers have a higher degree of confidence in our industry than they did before the pandemic. Plus, many dealers have developed new digital capabilities and more efficient processes that will allow them to sell vehicles with lower expenses. We expect dealership values will remain strong for the foreseeable future, but may begin to drop if vehicle margins fall and/or if expenses like advertising and floorplan creep up. Finally, buyers need to get a fair return on dealership acquisitions. They will pass on opportunities where sellers have unrealistic expectations. This keeps prices in check from doubling or tripling from pre-pandemic levels.

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Q: What impact does the customer-satisfaction index have on the value of a dealership?

A: Customers typically go online to start their buying process. Aside from looking at vehicles, customers also want to know what their experience will be like, and it's easier than ever to see reviews from prior customers. Most retailers have implemented customer-friendly processes that make buying a vehicle more pleasant and transparent than in the past and I think we all know that happy customers lead to happy dealers via higher profits and higher dealership values. If a dealership has a bad CSI score, then we would expect sales and profits to suffer, and that would reduce its valuation, of course. That said, I can't remember a transaction where a dealership buyer turned away from a transaction because the seller's customer-satisfaction ratings were low. In fact, it's the *buyer's* customer-satisfaction ratings that are most important in a buy-sell since some states' franchise laws allow an OEM to reject a transaction if the buyer's CSI scores are low. So CSI matters in buy-sells, but in a different way than what you might expect.

Q: Looking ahead to the next few years, what franchise brands do you see earning higher valuations? Are you watching any trends of note on a brand-by-brand basis?

A: At the moment, dealerships of almost every franchise are making record profits. Those franchises that have been taking market share for several years before the pandemic hit, such as Toyota, Subaru and Porsche, are likely to regain their momentum when production returns to normal. Kia and Hyundai dealerships used to have a hard time making the same profits as their midline import peers, but due to an improved product mix, we think they have become more desirable brands. Ford, GM and Stellantis have suffered the biggest drops in production due to the microchip shortage. It seems likely to us that they will enjoy the biggest lift in sales when they return to full production. The luxury brands and exotics are also doing extremely well. Due to increased wealth in the United States, more people can afford their products and we see a bright future for luxury franchises. I think we are entering a golden period in auto retail where almost every brand will thrive in the next couple of years.

Q: Looking ahead to potential changes to capital-gains taxes from the Biden administration, how do you see that impacting the buy-sell market? Are dealership sales actually accelerating as a result?

A: President Biden's tax plan calls for the top rate on capital to almost double. We have a number of clients who have retained us to sell their dealerships in 2021 since they don't want to take the risk of paying higher taxes in the future. So yes, the lift in buy-sells in 2021 is partly tax driven. The tax experts we have spoken to recently say while they are expecting some increase in taxes to offset the increase in spending, they believe the increase will be more modest than the Biden plan. If so, we would expect dealership sales to be strong in 2022 also.

Q: New players such as Tesla and Rivian are disrupting the traditional car-buying experience by selling directly to

consumers. How has the pandemic tested and proven the value of the tried-and-true dealership franchise model?

A: While thousands of retailers in other industries closed their doors permanently during the pandemic, we can't think of a single auto dealership that went out of business. We learned that dealerships are *essential* and were reminded that dealers remain formidable entrepreneurs who can react quickly to changing conditions. Dealers responded to the pandemic by adding online sales capabilities and providing touchless delivery options, including pick up and delivery. And they cut their costs quickly. Tesla and Carvana have proven there is a growing segment of the population that prefers a fully online and one-price process. They have certainly taken some market share from the franchised system, but dealers are now more focused on these customers, too. The new skills learned by dealers during the pandemic will help them better compete with new entrants to our industry. The dealership franchise model has been with us for more than 100 years. I believe our system will continue to adapt to meet the needs of consumers and OEMs while still remaining highly profitable for dealers.

ABOUT THE PANELIST

ALAN HAIG
President, Haig Partners
954-646-8921
alan@haigpartners.com

Since 1996, Alan and the team at Haig Partners have been involved in the purchase or sale of 520+ dealerships with a value of \$7.8 billion. They issue the Haig Report and co-authored NADA's A Dealer Guide to Buying and Selling a Dealership. Alan is frequently quoted in the media and speaks regularly at conferences.

