

BUY-SELL Q&A

DEALERSHIP CONSOLIDATION TRENDS

Increasing numbers of car dealers are deciding to sell their stores – a trend that’s creating expansion opportunities for auto groups both large and small. What factors are driving this consolidation trend and how long might it last? Experts from Flow Automotive, Cox Automotive and Haig Partners weigh in with valuable insights and perspectives.



Left – right: Don Flow, Dale Pollak, Nate Klebacha

Q: For more than 30 years, we’ve had mega dealers/groups, but single-point operators have done fine competing side-by-side with them. Are things changing now, and if so, why?

Don Flow, Flow Automotive: Single-point dealerships that are radically focused on providing a great customer experience will always create value for customers. But the challenge will be to retain the value in the form of sustained profitability. The costs associated with technology and retaining highly competent people, the differential in the cost of capital and accelerating marketing costs will erode profitability for organizations that cannot leverage these expenses across a large platform. Presently, we are in a very exceptional period for earnings. However, prior to this moment in time, we saw many single-point dealerships having a difficult time making three percent net to sales. Their semi-fixed costs and fixed expenses were higher than they would be if they were part of a larger group. We think if a store falls below three percent, it’s not creating sufficient returns to invest in [facilities technology] and people for the future. The exceptions to this are strong franchises in single dealer point markets that have healthy economies and population growth. These dealerships generate higher margins and the population increase ensures both variable and fixed gross-profit growth over a sustained period of time.

Dale Pollak, Cox Automotive: In my 2017 book, *Like I See It*, I wrote, “We’re entering an era where a growing number of dealers are in a position to use their economies of scale to consistently stock better new and used vehicles, sell and service them at lower prices and margins and make more money – all at the expense of their less-efficient, smaller-scale competition.” This passage sums up some of the reasons it’s become more difficult for smaller dealer groups, and especially single-point stores, to survive and thrive in recent years. The book chapter where the passage appears also points to the opportunity available for single-point operators to compete with larger groups by becoming hyper-efficient and more agile as they pursue every point of differentiation from larger competitors that can offer an advantage.

“...we expect this elevated level of consolidation to continue for some time.”

– Haig Partners

Q: Why should a dealer consider getting bigger?

Flow: Adding stores provides diversification and gives dealers more market presence and thus, a bigger platform in that market. In addition, you add to your “people portfolio” by bringing in competent new talent to the dealership. You also have financial returns that exceed the next best use of the dealer’s excess capital. But most importantly, when dealers expand,

they bring in a brand they like. It really is a business of the heart and if you don’t like the brand, your heart will never be in it.

Q: Are there any metrics/statistics that underscore the breadth and scope of this consolidation boom? Is it historic in nature?

Haig Partners: The buy-sell market in 2021 is certainly in record setting territory. We estimate there have been 241 US dealerships sold in the first six months of 2021, 59 percent more than the 152 dealerships sold in the first six months of 2019, before COVID. This is the highest level of buy-sell activity we have seen since the late 1990s when most of the public auto retailers had just been formed and were all out buying dealerships.

Q: What are the biggest factors driving the consolidation we’re seeing today?

Haig Partners: We see a confluence of two major trends that are driving faster consolidation. First, buyers are more aggressive. They are making record profits and are comfortable with the trends in the industry that will reward larger groups that have more access to capital, people and technology. Groups like this, such as Lithia, are confident about their futures in the auto retail industry and they want to own more stores. The other reason for more rapid consolidation is that a growing number of dealers are becoming concerned that it will be harder for them to compete in the future. They worry about the increased need for investments in facilities and technology. And

they wonder about the impacts of electrification, new OEM entrants, the desire for OEMs to sell directly to consumers, and other potential changes that could reduce the value of their businesses. And for some dealers, there is a bit of a rush to the exits in 2021 for tax reasons.

Q: Is the looming growth of electrified vehicles (EVs) affecting consolidation and if so, how?

Flow: I have not heard anyone say that EVs are the primary reason they are considering selling. However, I think the uncertainty of what EVs

will mean has added another layer of anxiety regarding the future of their businesses. A major concern is that their facilities are not designed for EV vehicles. And because facilities represent a large amount of their dealerships’ net worth, they believe that EVs put at risk the value of their facilities and their operating companies.

Q: What can dealers interested in capitalizing on this trend do to make their dealerships more attractive to buyers?

Haig Partners: Higher profits usually drive higher prices, but this is easier said than done. There are several things that all dealers can do to make every dealership more attractive to buyers:

- Make the dealership compliant with OEM requirements prior to a sale, or have a plan to do so. If the dealer doesn’t want to make the investment before a sale, they should be able to present a clear plan for how the buyer can satisfy OEM requirements. Have property under control, plans drawn, and bids from contractors in hand.
- Avoid long-term contracts. DMS contracts can be the most troublesome. Buyers won’t want to assume a contract with a vendor they are not using. This can cost a seller hundreds of thousands of dollars unless they can easily terminate the contract. Also try to wind down tires for life, oil changes for life, and other such loyalty plans that create issues for buyers.
- Market the dealership correctly. Describe the past and add-backs clearly, then show opportunities for upside to a buyer. Identify the most likely buyers. Then create a process that creates competition between these buyers to maximize the value of the business, while still maintaining confidentiality.

Q: Are there any Biden administration policy proposals or general political trends on the horizon that could affect this consolidation surge?

Pollak: We’ve already seen that President Biden’s tax-policy proposals, particularly those related to capital-gains taxes, are spurring some dealers to exit sooner to avoid the impact on their sales proceeds. I also believe that Biden’s plans for infrastructure spending, and the jobs and income this will create more broadly, will bode well for dealers and give buyers confidence in their acquisition decisions.

Q: Does this consolidation trend include more than just big auto groups buying smaller players or independent stores?

Haig Partners: It is not just a “big-boys game;” smaller groups are growing as well. In fact, most acquisitions are small to mid-sized private groups buying one to two stores.

Q: Dealerships today are using more technology than ever. How do you see consolidation affecting the ecosystem of technology and service providers who work with dealerships?

Pollak: I believe the community of technology and service providers will get smaller as dealership consolidation continues. In fact, we’re already seeing consolidation. Larger technology companies are buying up smaller technology companies to broaden their value proposition for larger dealer groups, who will increasingly look to standardize the way they do business across growing numbers of rooftops.

“At \$2 billion in revenue, there are significant areas of efficiency and effectiveness that begin to offer meaningful operational advantages.”

– Don Flow, Flow Automotive

Q: How long do you think this consolidation boom will continue?

Haig Partners: Our industry is still highly fragmented compared to other retail industries. The top 150 groups control just 22 percent of new vehicle sales. Lithia Motors has ramped up its growth via acquisitions and the other public companies also have announced plans for growth with more acquisitions. Plus, we are seeing lots of demand for dealerships from well-funded private groups. When we see this level of long-term demand, coupled with many dealers who are interested in selling due to age, lack of succession plans or concerns about competing with larger dealers, we expect this elevated level of consolidation to continue for some time.

Flow: I think it is realistic to expect our industry to take the following form:

- National companies: Greater than \$10 billion in sales.
- Super-regional companies: Greater than \$5 billion in sales, with a focused geographic orientation in at least two states.
- Regional companies: \$2-\$3 billion in sales, focused in a few major metros or in a variety of Tier 2 metros.
- Tier 3 market-dominant companies: \$500 million to \$1 billion in sales, focused on buying the majority of dealerships in one or more Tier 3 markets.

ABOUT THE PANELISTS

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HAIG PARTNERS

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Since 1996, the team at Haig Partners have been involved in the purchase or sale of 525+ dealerships with a value of more than \$7.8 billion. They issue the Haig Report and co-authored NADA’s A Dealer Guide to Buying and Selling a Dealership. www.haigpartners.com 954.646.8921 • info@haigpartners.com



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