

BUY-SELL Q&A

VALUING DEALERSHIPS IN UNCERTAIN TIMES

Valuing dealerships is complicated as buyers weigh many factors when determining how much they will pay in a transaction. The buy-sell market has changed dramatically from 2019 as profits surged, and valuations are changing again as conditions begin to get tougher. Past valuation methodologies may no longer accurate in determining blue sky value, so sellers must run a competitive auction process in order to uncover the Most Motivated Buyer® for their store(s).

Q: Do you think the elevated earnings dealers are enjoying will continue much longer?

Alan Haig: There's a lot of confusing noise in the economy right now with inflation, rising interest rates and a falling stock market, but also increased employment and greater household wealth. Dealership profits more than tripled since the Pandemic hit. Profits likely peaked in the first half of this year, but we believe dealers will be enjoying elevated profits for some time. By our estimate, there will be pent-up demand to purchase more than five million new vehicles in the United States by the end of 2022. Even if the OEMs manage to significantly increase production, it could take more than three years to fulfill this pent-up demand. In the meantime, profits on new vehicles should remain a good deal higher than in pre-Pandemic times.

As an "added bonus," so long as consumers have a hard time purchasing a new vehicle, they will be eager to buy used vehicles, and they will continue to pay for parts and repairs for their existing ones. All profit centers for franchised dealers should continue to perform well during the next few years, albeit at lower levels from the record profits we enjoyed so recently.

One factor that could derail this period of slowly declining profits is a severe recession. If that happens, we'll see lower demand, which would lead to cut sales and margins. Profits could fall significantly.

Q: We are almost through 2022. What are you seeing in terms of dealership values?

Haig: They are still strong. The amount of blue sky paid for dealerships almost tripled from 2019 to the middle of 2022, thanks to sky-high profits. Our data indicate that blue-sky values may have peaked in the first half of 2022 along with the record high profits. We estimate that blue sky values have declined slightly, but the average estimated blue sky value for a dealership is still more than double what it was in 2019. Times remain very good for sellers.

While profits may have topped out, buyers and investors across the country are still looking for acquisition opportunities. They understand that earnings will fall, but they remain interested in growing their companies. This strong demand for dealerships is keeping valuations near record levels. Dealers prefer the returns they can get from acquisitions compared to almost any other investment alternative. Plus, dealers have more cash than ever before and leaving it in the bank is costing them money due to the high inflation.

Q: How are dealerships being valued today?

Haig: That's not an easy question to answer! We focus on valuation every day. We provide clients and potential clients an estimate of the amount of blue sky the Most Motivated Buyer® (the one dealer that places the highest value on



Alan Haig

a dealership or group) would pay them for their dealership(s) in addition to the real estate and other related assets. Every transaction is different, as each dealership has unique attributes that will impact its valuation. Performance, location, facility price and condition all have a big impact on the value a buyer is willing to pay. Plus, and since conditions are changing, it's impossible to have perfect information about how buyers will bid by the time we get to market. Therefore, our valuations include a low and high estimate for goodwill. By providing these valuations, our clients and potential clients have a good idea about what they can expect.

Before the Pandemic, our valuations were extremely accurate. Our clients who sold in 2019 received 98% of the mid-point of the high and low ranges for our blue-sky estimates. When you include the values of the real estate and other assets, our predictions of the total value our clients would receive was around 99% of the mid-point that we obtained for them. That's pretty darn good! Our accuracy came from being involved in buy-sells for well over a hundred dealerships between 2014 and 2019. The economy during that time was very consistent, and so were dealership earnings. Stability allows accuracy.

As the market changed in 2020, so did valuations. When the Pandemic hit, the buy-sell market evaporated for a few months. That scared sellers and gave buyers leverage. When deals started to close again in June 2020, valuations had fallen below 2019 levels. The blue-sky values our clients accepted in 2020 were at 86% of the mid-point we had estimated for them since our estimates were mostly done before the Pandemic hit.

As profits exploded in 2021, valuations jumped also. We knew conditions were getting better, so we boosted our valuation methods. Buyer demand, thankfully, was even stronger than we expected. The blue-sky values that our clients accepted in 2021 were 106% of the mid-point that we had estimated for them.

After seeing the strong results in 2021, we again elevated our valuation methodology for the estimates we provided our clients in 2022. But the demand was again greater

than we anticipated as profits tripled from pre-Pandemic times. The blue-sky values our clients accepted so far this year on closed transactions were 119% of the mid-point of the estimated range we provided. And for our transactions where offers have been accepted but have not yet closed, the amount of blue sky is 144% of the mid-point of our estimate. Our clients have been thrilled with the results of our sale processes in recent years and we pride ourselves in under-promising and over-delivering, but we also like to be accurate.

We share this valuation data to demonstrate that when conditions are stable, it's relatively easy to predict the amount of goodwill a buyer will pay as long as you have a lot of transaction data to support the valuation. But when conditions are changing quickly, valuing dealerships becomes more difficult, even for a firm like ours that will sell around 50 dealerships this year.

Due to mixed trends today, the outlook for dealer profits is again unclear. Some buyers are bullish and want to acquire dealerships that fit their strategy and will offer a high price. Others are cautious and may withdraw from the market until conditions stabilize. These varying perspectives make it difficult to accurately project today how a buyer would value a dealership 30 days from now.

Dealers, accountants or dealership brokers who are estimating values today are basically guessing. Our hunch is that blue sky values have fallen about 10% from their peak.

The only sure way to determine the highest value for a dealership or group is to run a marketing process to surface the Most Motivated Buyer®.

Q: What do you mean by the Most Motivated Buyer? How do you find that buyer?

Haig: Our marketing process varies with each transaction, as each client has a different blend of objectives.

Typically, our clients are looking to maximize the value of their lives' work so we go out to multiple buyers that we know are looking for acquisitions similar to the one that we are representing. After they sign confidentiality agreements, we provide them with the offering materials we've prepared, which provide buyers with all the information they need to make an informed offer. Often, we receive several similar offers and negotiate with multiple buyers before choosing the best counterparty. Occasionally, we may receive an offer that is as much as 50 percent higher in goodwill than the next closest offer. When this happens, it reminds us that value is in the eye of the beholder. Same franchise, same financial results, same location, same facility – but a much different price! The Most Motivated Buyer® may bid far more than the next buyer for many reasons. This variation in valuation is why we don't set a blue-sky asking price when going to market. If we ask for too much, we might not get any bids. And if we ask for too little, we leave money on the table. We believe it's best to let the market speak and then negotiate from there by showing additional value the buyer might have overlooked.

In a transaction in which our client is extremely concerned about confidentiality and price is not the only consideration, we may just go to a single potential buyer that we believe is the Most Motivated Buyer® and offer them an exclusive period of time to make an offer. We do this when we have a high degree of confidence that we know who the best buyer will be for that particular business. For instance, working with the owners of John Elway Crown Toyota, I made a call to a single potential buyer. After he signed the confidentiality agreement and reviewed the information we prepared, we negotiated a price the seller was pleased to accept. Word of the transaction never leaked until the owners were ready to notify their people and Toyota. It's possible that another buyer would have paid slightly more, but the seller also wanted to make sure that Toyota was happy with the buyer as they have strong ties to Toyota.

Q: What can dealers do to get the highest value when they decide to sell?

Haig: Performance matters a great deal. High earnings, strong CSI and good management will attract attention from many potential buyers. Facilities that are image compliant are also a plus.

Once they have done all they can with operations, sellers need to run an effective sales and marketing process.

They need to begin by compiling all the information a buyer would need to know to make an informed offer. Our firm creates comprehensive marketing materials based on what we know leading buyers want to see - the same materials we provided for AutoNation and Asbury Automotive when we

worked for those firms. In addition to describing historical results, we show potential buyers the various ways that they could improve the performance of the business after they acquire it.

Next, to maximize value, a seller needs to identify a limited number of most likely buyers, then figure out a way to get these potential buyers to sign confidentiality agreements without first disclosing his identity. It's not always obvious who the Most Motivated Buyer will be. On some of our transactions, the Most Motivated Buyer® is local and well-known to our clients. However, they paid more because they were involved in a competitive process. In most of our deals, we bring a buyer that our client would not have known to contact.

Finally, a seller needs to create competition between the buyers to maximize the value of the business.

Twice in my career I headed up the acquisitions team at AutoNation. I always wanted to be the only buyer talking to a potential seller because then I was setting the price. But if a dealer was talking to multiple buyers, then we always ended up offering more since I knew I had to compete to win the deal.

For decades almost every dealer sold their stores without a buy-sell advisor. This has changed as the values of dealerships have gone up. Just look in Automotive News. In the August 29, 2021, edition, 17 sale transactions were listed for 40 stores. Ten of these sellers were represented by buy-sell advisors. Haig Partners represented three sellers that owned 13 of the 40 dealerships that were sold. The owners of these groups decided they would be far better off with a buy-sell advisory firm rather than selling their stores on their own. For more information on how buy-sell advisory add value, please refer to the [Automotive News Expert Q&A: Value of an M&A Advisor](#).

We are grateful for our clients' trust in us and proud that every one of them is willing to serve as a reference. I believe all our clients would say that we helped them maximize the value of their lives' work®.

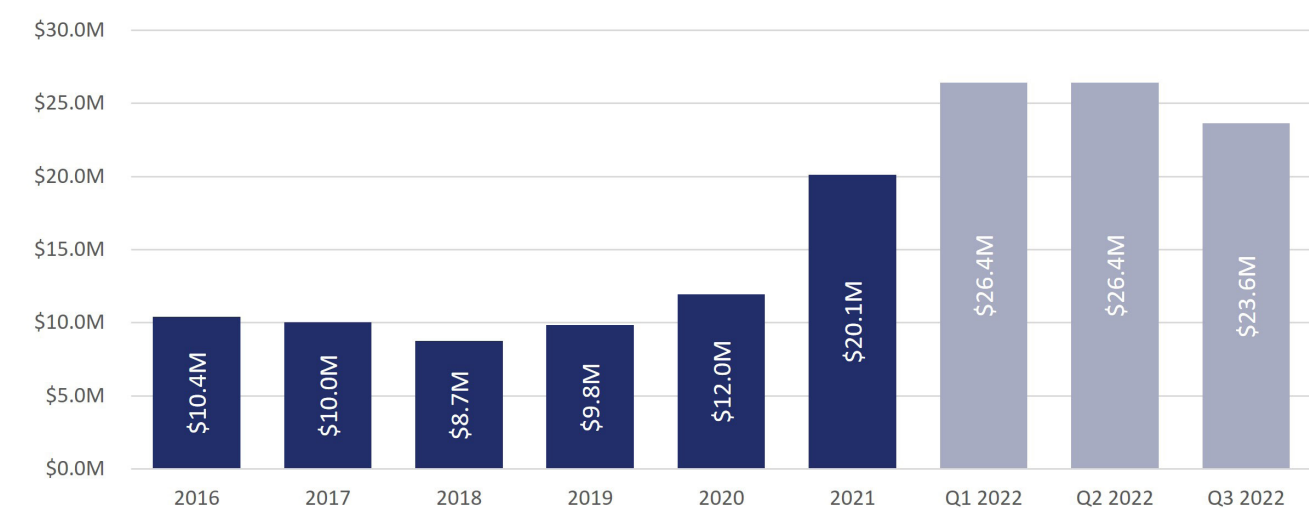
ABOUT THE PANELIST

ALAN HAIG • President, Haig Partners

Haig Partners LLC helps dealers maximize the value of their businesses when they are ready to sell. The team at Haig Partners has unmatched experience with executives from leading retail dealer groups and financial institutions and have advised on the purchase or sale of more than 590 dealerships for over \$9.3 billion, and have represented 24 groups that qualify for the *Automotive News* Top 150 Dealership Groups ranking, more than any other firm. Haig Partners leverages its expertise and relationships to lead clients through a confidential and customizable sales process that also maximizes the value of their businesses. They author the [Haig Report](#), the leading industry quarterly report that tracks trends in auto retail and their impact on dealership values, and are co-author of NADA's Guide, "Buying and Selling a Dealership." For more information, visit www.haigpartners.com, or contact Alan Haig at alan@haigpartners.com or (954) 646-8921.



ESTIMATED AVERAGE BLUE SKY VALUE BASED ON PUBLIC GROUP EARNINGS



Source: Haig Partners & SEC Filings