BUY-SELL Q&A

VALUE OF BUYING vs. BENEFIT OF SELLING DEALERSHIPS TODAY

As dealers navigate a downturn in dealership profits, one thing remains abundantly clear: The buy-sell market remains remarkably active. For the first half of 2023, an estimated 270 dealerships changed hands. If the current pace continues, 2023 will turn out to be the third-most-active year for transactions and more than 50% higher than a typical year before the pandemic. What are the compelling reasons behind the continued interest in buying and selling dealerships? Pete Thiel, managing director at Haig Partners, provides insights. Thiel has been involved in the purchase or sale of more than 150 dealerships and has evaluated more than 1,000 acquisition opportunities. His background includes more than 20 years at AutoNation, where he served as vice president of corporate development, leading all acquisitions and divestitures.

Pete Thiel

Q: What is driving the vibrant buy-sell market we are currently experiencing?

Pete Thiel: The market moves in cycles. During the recession back in 2008-2009, transactions slowed to almost zero because buyers were nervous about the future, and sellers didn't want to sell at a low price. We have seen a remarkable increase in post-pandemic dealership profits – more than three times higher – primarily due to the supply/demand imbalance on new vehicles as supply chain disruptions dramatically reduced dealership inventories. As profits tripled, blue-sky values doubled, as most buyers assumed that profits would decline when COVID dissipated. Many sellers took advantage of the higher values, so the number of transactions exploded. For reference, more than 700 transactions occurred in 2021 and more than 600 in 2022. The environment has been good for both buyers and sellers, and it takes two motivated parties to complete a transaction. Buyers have had plenty of cash and optimism about the future. Sellers have obtained record prices.

Q: Are there any headwinds in the industry that could slow buy-sell activity?

Thiel: Most dealers are experiencing declining profits as certain economic conditions create headwinds for auto retail. Inflation skyrocketed to levels not seen in decades, and the Federal Reserve has raised the federal funds interest rate 5-plus percentage points, to a level not seen in 22 years. Higher interest rates make everything more expensive, whether it's monthly payments for consumers or floorplan expenses and acquisition loans for buyers. Dealers are beginning to feel the effects of lower margins, higher expenses and lower profits. Declining profitability, combined with the economy entering a recession as opposed to a soft landing, could dramatically slow activity. Dealers are also monitoring the negotiations between the United Auto Workers union and each of the Big Three automakers. As of this writing, the UAW called a strike at three plants. A prolonged strike could be economically devastating for the industry.

Q: Why are buyers still so active in a declining market?

Thiel: Despite these recent headwinds, auto retail conditions are still strong and many dealers are confident about the long-term outlook for the industry. I get calls every week from dealers looking to grow. For many reasons, it is still a good time to buy a dealership:

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Resilient Economy: While higher interest rates have put negative pressure on dealership financial results, there are some bright spots in the economy that are showing positive signs for buyers. The annual inflation rate slowed to 3.2% in July, much lower than July of last year, at 8.5%. Many economists believed we would need to see significant job losses and a recession to curb inflation, but this has not been the case thus far. Unemployment is still low at 3.8%, and the economy is still adding jobs, albeit at a slower pace. With inflation declining, many analysts expect the Federal Reserve to begin cutting rates at some point in 2024. While a recession may still occur in the next 12 months, it should be short-lived, if it occurs.

Strong Balance Sheets: Profitability is declining but remains much higher than pre-pandemic results. This has generated large cash balances on financial statements and low levels of debt. Dealers need to put this money to work, and many prefer reinvesting in auto retail versus other financial markets where returns may not be as robust.

Pent-Up Demand: We estimate that dealers will experience tailwinds for some time in selling new vehicles. The supply chain disruptions caused by the pandemic have limited production of new vehicles the past few years. Prior to the pandemic, car buyers were purchasing 17.3 million vehicles on average each year. If we assume that this continued for the next four years, there could be as many as 11.2 million units that would have sold, had they been produced. Even if we cut this number in half, it appears that pent-up demand will keep consumer demand higher than supply, which will drive elevated margins and profitability for the foreseeable future.

Fixed Operations Growing: Gross profits for service and parts have steadily increased since the pandemic. With new vehicles in short supply, vehicle owners have been keeping their vehicles longer and spending more money to maintain them. The average age of a vehicle is now 12½ years, a record for American car ownership. Dealers have also done a good job raising their labor rates to keep pace with inflation. As a result, fixed operations gross profit for the public companies was up 9.7% through the second quarter compared with the same period last year. And as vehicles become more complex, dealers should be able to compete better against independents.

Consolidation Continues: When I started working at AutoNation in 1999, consolidation was the big topic in the industry. We all thought the public companies would grow to more than 1,000 stores and dominate the industry. That didn't happen. Consolidation has picked up speed again in the last few years as public and private companies have aggressively acquired stores. We believe that smaller dealers and auto groups need to grow to thrive in the future. Customers want a huge selection of vehicles to select from, a fair price and a seamless transaction process. It is all about digital now as the pandemic accelerated the shift to online shopping. Larger dealership groups will have an advantage as inventories continue to rise and dealers start to compete for customers again. They can offer a wider variety of vehicles to consumers as they combine all their individual store inventory on their main websites. Many large dealers have an advantage because they've been able to spend millions of dollars designing and refining their digital offerings. Growing in size to an eight- or 10-store group – or even larger – will enable dealers to compete regionally with larger players in the industry.

Higher Earnings: Dealerships are making more money today compared to pre-pandemic. Most dealers believe profits will land somewhere between 2019 and 2021 levels, permanently higher than in the past. Although dealerships are more expensive today vs 2019, this structural lift in earnings still allows buyers to generate strong returns.

Q: What are some of the reasons sellers are motivated right now and driving transaction volume?

Thiel: The primary reason is that blue-sky values are high right now relative to the past. Sellers like to sell at high prices! We estimate that the average blue-sky value per publicly owned dealership in the second quarter only declined by 7.3% compared with year-end 2022, which was the peak. Blue-sky values remain very strong. There also is a lot of discussion and concern today regarding the transition to electric vehicles. Many dealers are concerned that OEMs are pushing EVs too quickly and outpacing consumer demand, which could substantially lower front-end gross profit in the future. Some dealers also are unhappy about large capital expenditure requirements, the potential for declining fixed-operations gross profits, and complicated dealer reward and incentive programs related to the transition to EVs. These are examples of current industry-specific reasons why many dealers are contemplating a sale today. These are separate and distinct from typical reasons dealers consider selling, such as retirement, burnout, diversification, lower risk, partner issues and so forth.

Q: Why would it be more beneficial for a dealer to sell today vs. tomorrow?

Thiel: In a declining market, sellers will typically generate higher blue sky proceeds today vs. the future. Assuming dealers are correct, and profits end up somewhere between 2019 and 2021 levels, profits could fall another 30+%. The higher blue sky offset by the income generated from the store over time could lead to higher net proceeds for a seller today.

Q: Would you recommend selling now if a dealer was considering retiring in a few years?

Thiel: It is an extremely difficult decision for most dealers, as they must weigh many conflicting factors. Focusing solely on the numbers, yes, it is still a great time to sell, as blue-sky values remain elevated relative to pre-pandemic levels. I often tell dealers that if they are considering retirement in the next three to five years, they should think about a sale sooner rather than later. Our firm can help dealers who are thinking about a sale by providing no-cost valuations and advice on what we are seeing in the market today. We also routinely provide honest qualitative advice dealing with all the ups and downs of deciding to sell, as well as the sales process itself, which can be quite an emotional roller coaster.

Q: You were responsible for buying and selling stores for one of the largest auto retailers in the industry. What advice do you have for dealers who are talking directly to a consolidator or larger retailer about selling?

Thiel: When I was at AutoNation buying stores, we always wanted to work with sellers directly because we knew we would be able to purchase the store at a lower price vs. a sale via an advisor. We didn't want to compete against other buyers in the market. At Haig Partners, we utilize our experience, industrywide network and highly effective sale process to generate higher proceeds for our clients. Having worked on buying or selling almost 540 dealerships, we have also encountered almost every issue that comes up in a transaction. We know what market value is, and we can protect our clients on issues that arise during due diligence and legal-document negotiation. Working with a buyer directly could cost a seller money at closing and leave them exposed to unnecessary liability after the sale.

Q: Any other thoughts or advice for dealers considering a purchase or sale of a dealership?

Thiel: As discussed, the buy-sell market is still very active. We expect this to continue for the next several years, so it still is a great time to both buy and sell a store. My favorite part of my job on the sell side is using my experience to truly help clients generate a favorable outcome. It is not easy! Don't be afraid to leverage the experience of a trusted advisor; values are too high today to risk selling a dealership yourself. It is an enormous amount of work to buy or sell a store and it is extremely important to not get distracted and to keep your operations running strong. We would be pleased to discuss current market conditions and help you navigate the intricacies of buying or selling a dealership. Reach out to us today for expert guidance and unmatched service.

ABOUT 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. The team has advised on the purchase or sale of more than 540 dealerships worth more than $9.4 billion and has represented 26 groups that qualify for the annual *Automotive News* list of Top 150 Dealership Groups, 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. It publishes the Haig Report, the industry-leading quarterly report that tracks trends in auto retail and their impact on dealership values, and co-publishes the National Automobile Dealers Association's guide, Buying and Selling a Dealership. For more information, visit www.haigpartners.com or contact Pete Thiel at **pete@haigpartners.com** or **(954) 478-5784**.

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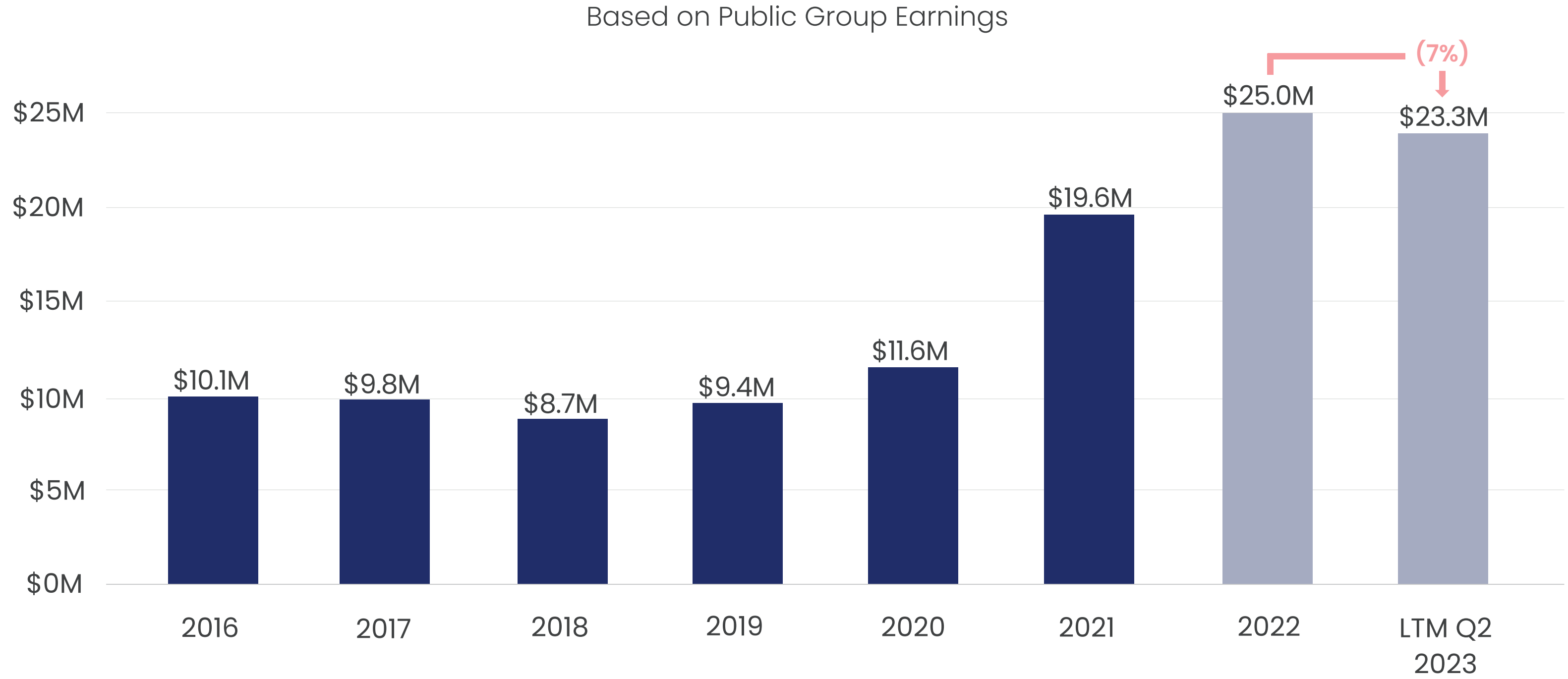

Source: *Haig Partners & SEC Filings*

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