The first quarter of 2017 brought slightly less robust conditions for auto dealers, with expenses rising and eating into profits. Consumer confidence remains high so analysts expect sales will remain over 17 million units for the third year in a row. Buy-sell activity fell sharply in Q1 for reasons we will discuss below. We expect 2017 will be another good year for buy-sells as we are seeing high levels of activity across the country. Buyers continue to be excited about auto retail so values remain strong for attractive deals, although they are increasingly picky and over-priced deals get little interest.

### The Buy-Sell Market Remains Active

The total number of US dealerships purchased by public and private dealers fell 29% from 113 rooftops in Q1 2016 to 80 rooftops in Q1 2017, based upon data from The Banks Report. This is a surprisingly large drop and there are several potential explanations, although it is too early to determine for sure.

Sales of dealership groups fell sharply. Stores in group transactions represented 44% of all stores sold in Q1 2017, down from 62% in Q1 2016. The average group size declined slightly from 3.3 stores to 3.2 stores. Domestic stores made up 49% of the stores sold in Q1 2017 compared to 43% of Q1 2016. Buyers appear to be attracted to these dealerships due to their strength in trucks and SUVs. Luxury stores had the biggest decline, making up just 14% of volume in Q1 2017 compared to 22% in Q1 2016. Midline import stores were 37% of volume compared to 35% last year.

One potential reason for the decline in transaction activity is the Presidential election: buyers and sellers wanted to wait until the results were in before agreeing on terms. And since closings typically lag the execution of definitive agreements by 90 days or so, this could mean that the market froze up in Q4, during the election period. Another potential explanation is that buyers are increasingly concerned about future profits and sellers are not willing to accept the prices being offered to them. We have seen both of these things happen in our practice in recent months. Lastly, Q1 2016 was a very strong quarter with the second highest store and transaction volume in many years.

Most of the public companies remain cautious on acquisitions. Only two of the six public dealer groups acquired new franchised dealerships in the US in Q1: Penske and Asbury. It is encouraging to see Asbury in the market again since their last acquisition was nearly two years ago. While Penske acquired a Jaguar-Land Rover store in Q1, it was a small portion of their acquisitions with most of their money spent on a used
vehicle group in the US, another used car group in the UK and a VW/Audi store in the UK. AN acquired a collision center but no new stores while Sonic made no acquisitions in Q1. In April, Lithia announced the acquisition of the Baierl Auto Group in Pittsburgh with $500M in annual revenue, and they are committed to more deals this year, putting it on pace to be the most active of the publics in 2017, just as it has been for the past three years. Penske closed on the acquisition of a large Mercedes-Benz store that will be reported in its Q2 numbers. The bottom line is that while the amount of spending by the publics on acquisitions of all kinds in the US increased in Q1, much of the increase was in stand-alone used car stores and collision centers. Spending on US franchised dealerships was likely much lower in Q1 2017 than Q1 2016, but the exact amounts are impossible to quantify given how the publics report their numbers.

Source: SEC Filings

Haig Partners is not a traditional dealership brokerage firm. We do not seek “listings” of many dealerships. Instead, we provide the best possible advice and service to a limited number of clients, helping to optimize the sale of their most valuable asset. We combine the skills gained during our years in investment banking with the experience of buying and selling dealerships for AutoNation and Asbury. We spend a tremendous amount of time and energy on each engagement. Emphasizing quality over quantity best serves our clients’ interests.

Of course, all buy-sell advisors say they are experienced and effective. We encourage any dealer who is considering hiring a firm to ask a few simple questions of the advisor he or she is talking to:

1. How many dealership sales have you, personally (not your firm), closed in your career?
2. Can I speak to your last ten clients to learn about how you added value?
3. Why should I choose you over another advisor?

We enjoy answering these kinds of questions. Haig Partners offers unmatched experience in our industry, and we are pleased to connect you with our former clients for references.
Blue Sky Multiples Are Mostly Unchanged

Despite the recent downturn in M&A activity, we have not seen any meaningful movement in blue sky multiples since we released our Year End 2016 Haig Report. Dealerships in attractive markets with no facility issues continue to bring strong prices, but dealerships that have some kind of “hair” on them are attracting little interest from buyers since they have many acquisition options. We also continue to see more investment firms seeking to purchase dealerships. These family offices and private equity firms are supporting the pricing for dealerships since they are looking for both single store acquisitions as well as acquisitions of mid-to-large dealership groups.

The table below provides our estimate of what multiple a buyer participating in a competitive sales process (i.e. not the only buyer at the table) would be willing to pay for the goodwill of a franchise, in addition to the other assets. The blue sky multiple is partly a reflection of the risk/reward profile that investors place on each franchise. Higher risk franchises command lower multiples, while franchises that are perceived as lower risk bring higher multiples. Some OEMs like Toyota/Lexus, Mercedes-Benz, and BMW also offer large amounts of credit to buyers of their dealerships, which helps to boost the returns from buying their dealerships. The net result is a risk-adjusted return profile as determined by the market. Of course, actual multiples or prices paid by buyers could be higher or lower than the ranges we indicate. Stores that are not marketed properly and dealerships with facility issues will bring lower multiples. Underperforming dealerships can bring much higher multiples. Metro stores typically bring higher prices than stores in rural areas. Dealerships in states with no income tax usually bring premiums to dealerships in high tax states. In other words, each store is unique and brings its own set of opportunities and challenges. We caution readers not to view these values rigidly.
Overview

Dealers tell us it is getting increasingly difficult to maintain profits. With sales flattening and continued pressure on new and used margins, dealers must now excel at used vehicles, F&I and fixed operations while controlling expense creep and carefully managing their inventory.

Macroeconomic Indicators Are Mostly Positive

There are a number of key factors that influence consumers who are considering purchasing vehicles and most are still trending in a positive direction:

- **GDP Is Growing.** After growing 3.5% in Q3 and 2.1% in Q4, GDP growth for 2017 is forecast at 2.1%.

- **Employment and Household Income Are Increasing.** The US added over two million jobs in 2016 and is on pace to exceed that level in 2017. The unemployment rate in April stood at 4.4%, the lowest rate since May 2007, and was 2.4% for college graduates. Wages grew 2.7% in Q1, the 2nd best growth rate since 2009.

- **Number of Miles Driven Is Increasing.** The total number of miles driven, which influences the vehicle replacement rate and is a key measure of demand for autos, increased 2.8% in 2016 compared to 2015 and another 1.9% in the first two months of 2017 according the US Federal Highway Administration.

- **Gas Prices Remain Low.** The Department of Energy reported that the average price per gallon of fuel was $2.35 through early May 2017, up from $2.14 during 2016 and down from $2.43 in 2015 and $3.62 in 2012.

- **Consumer Sentiment is High.** There is a strong correlation between auto sales and consumer sentiment. As the chart at right shows, consumer sentiment remains near historically high levels, thanks to a sharp bump after the election. Consumers have a positive outlook and that is helping to keep new and used vehicle sales near record high levels.

For all the economic positives, there are a few indicators headed in the wrong direction and are giving some dealers concerns about the future:

- **Loan Losses Are Increasing.** While auto loan balances have exceeded $1 trillion for the first time, some lenders are seeing higher charge-off rates. The subprime sector is deteriorating fastest, with net losses hitting 10% in late 2016, up from 7% a year earlier and 5.9% the year before that, according to Fitch Ratings. Recent reports have indicated several banks have tightened standards for sub-prime borrowers and that may be one reason new vehicle sales have trended down slightly so far in 2017.

- **Interest Rates Are Increasing.** The Fed has been increasing rates and expects more increases as the economy continues to grow and we see upward pressure on wages and other measures of inflation. Higher rates are beginning to eat into dealers’ profits, particularly when vehicle inventories are high and many dealers have built expensive facilities in recent years that are financed with floating rate loans.

- **Profits Are Declining at Most Dealerships.** Per NADA, profits for the average privately owned dealership fell 8.5% in Q1 compared to Q1 2015. Public company filings show operating income falling at four of the six publics in Q1, with the group down an average of 2.3%, despite a significant amount of acquisition spending by some of them in 2016.
2017 New Vehicle Sales Are Slightly Down from 2016

After 2016’s record high sales of 17.55M new units, 2017 is off to a choppier start with a decline of 2.4% through April. Many dealers had a tough January and February followed by an excellent March and then a disappointing April. In the chart below, we show an estimate from NADA for 2017 of 17.1M units, representing a 2.2% year/year decline. The factories have all set their production schedules for 2017 so sales are highly likely to exceed 17M new units, the main question is what is the level of OEM incentives and price cutting by retailers needed to reach this figure.

Note the data above is for total new vehicle sales. So far in 2017 retail sales are holding up well. In the chart below, JD Power shows that the US Retail SAAR improved at the end of 2016 and the 3-month average for April 2017 is slightly above the levels from the first half of 2016. This is encouraging data and shows that consumer demand is still healthy.

Inventories Are Growing Even as Incentives and Leasing Are Near “Red Line” Levels

Some dealers are concerned about a number of trends in auto retail. They believe the OEMs are ignoring warnings signs that they are overproducing new vehicles which could lead to sharp pull back in the future. In his Q1 2017 earnings call, Mike Jackson said, “Incentives are now at 10.5% of MSRP...To me, 10% has always been a red line...30% leasing has always been a red line...inventories above 70 days is a red line. And we have three red lines that the industry in total is over on new vehicles.”
TRENDS IMPACTING AUTO RETAIL

The chart at right shows that incentives have been rising steadily and have reached the highest level in many years. While retailers complain that their margins are suffering, the OEMs are also enjoying lower profits per unit as they discount their products to attract customers.

Leasing is another indicator of the health of the auto industry. Leasing can stimulate demand for vehicles since it reduces monthly payments to consumers, but it can lead to risks for OEMs. The danger is that if OEMs decide to stop overresidualizing lease vehicles then sales could slow quickly. The evidence of this shows up when those vehicles come off lease and the OEMs suffer losses when their market values are much lower than the residual values in the leases. Ford recently said it is now losing about $1,000 per unit coming off lease where as from 2010-2015 it had wholesale profits. We believe Lexus was losing significant sums on its lease portfolio last year and raised its lease payments to new customers which may be one reason its sales have fallen 15% so far in 2017. When leasing reaches over 30% many in our industry believe OEMs are stimulating sales and we have been at or above 30% for much of the past year.

The last of these three “red lines” is inventory, which as the chart below right shows has grown to over four million units and the days supply has increased from 66 days in Q1 2016 to 73 days in Q1 2017. Retailers fear excess supply will lead to lower margins, higher floorplan rates, and higher compensation as a percentage of gross profit since they will need to pay salespeople flats and minis to move the units. Many dealers we speak to say they are refusing inventory from OEMs, even Toyota, until they can begin to clear their lots to levels they think better match future demand.

Although total inventories have grown, the luxury brands have done a good job at reducing the oversupply of cars that we saw in 2015 and 2016 that led to crashing margins, higher floorplan expenses, and playing games with “punching” new cars into loaner fleets and used car lots. We expect luxury dealers may be enjoying a slight lift in their gross profits per auto retailed, particularly as they have also improved their mix of sales to a higher percentage of CUVs to better match consumer demand.
Vehicle Grosses Continue to Decline

New vehicle profits per vehicle retailed fell 2.6% in Q1 for the public retailers, perhaps due to some of the reasons listed above. Leading retailers we speak to seem to be resigned that the OEMs want these margins to decline to help boost sales, and that they are not going to take many measures to reverse this slide. Used vehicle gross profits at the public retailers were down 9.0% in Q1 but this was largely driven by much lower margins at AutoNation that said it sold off the used units it had in inventory that were blocked by the stop-sale orders due to product recalls. And as more used units become available to dealers, it seems likely that grosses on used vehicles will continue to fall.

Finance & Insurance Departments Are Generating Record Profits

Gross profits from F&I continue to grow, which is helping to offset the decline in gross profits per vehicle sold. In Q1, the public groups reported gross profit per vehicle retailed reached $1,428, up 2.4%, or $34 per vehicle, from Q1 2016. Five of the six publics improved in this area, though the rate of improvement was the slowest of the last seven years.

Fixed Operations Driving Higher Profits

Seven years of rising sales have significantly increased the number of units in operation. Also, the large number of recalls have boosted service departments. Private dealers reported fixed operations increased 4.4% so far in 2017 compared to the same period in 2016. Public retailers also did well, averaging 3.0% growth on a same-store basis in Q1 2017 compared to Q1 2016. Higher profits from fixed operations may continue to support dealership profits even if vehicle sales and/or margins worsen.

Dealership Expenses Are Growing Faster Than Gross Profit

Rising costs appear to be the greatest threats to dealership profits. NADA data shows the average dealership during Q1 2017 enjoyed an increase of 2.7% in revenue, an increase of 1.8% in gross profit, but an average increase in costs of 6.1%. SEC filings indicate the public companies fared similarly in Q1 with revenue and gross profit both up 2.7% but SG&A up 4.0%. The leading culprits were higher labor costs, facility costs and floorplan expense.
Dealership Profits Drop Slightly

The net outcome of the trends listed above is that profits at dealerships declined 2.0% from full year 2016 to the last twelve-month period ending March 2017. This is still a very robust level and many dealers we spoke with are pleased with their results. However, when we compare Q1 2017 to Q1 2016 we see a decline of 8.5% in dealership profits year over year. This is potentially alarming, although it is too soon in the year to be able to accurately predict where profits will end up.

The table below shows the annual change in profits at privately owned dealerships since 2009. The seven-year run in growth of profits at dealerships appears to be at an end. Prior to the Great Recession, during the 2001 to 2007 period when new vehicle sales were at a plateau, NADA data showed that annual profits per dealership fell by about 5% per year as falling margins and rising costs took a toll. It is possible we are now entering a similar cycle.

After having a strong Q4 with 4.5% growth, 2017 started poorly for most public retailers with the group being down an average of 2.3% in profit in Q1. But there is also a wide range of performance for the public retailers with profits at Lithia up a strong 9.4%, partly because of a lot of acquisitions in 2016, while Sonic fell a surprising 30.1%, partially due to heavy start-up expenses with some of their new used car dealerships and hail losses. If Sonic were excluded from this group, the publics’ pre-tax profits in Q1 were about flat to last year.
Sales Growth for Individual Franchises

The following chart sets forth the change in new unit sales at the major franchises for the first 4 months of 2017. Note these are total sales so they include fleet sales that cloud the results at the retail level. About half of the franchises are up while the other half are down. Lexus is having a terrible start to the year as it resets its leasing programs. Ford and FCA are losing share despite being heavy in trucks and SUVs. On the positive side, Jaguar-Land Rover continues its sales explosion and Infiniti, VW, Subaru, Porsche and Audi all had solid gains. After a rough 2016, BMW is now beating the market, showing that it is producing more of the vehicles that consumers want.

Dealers Are Increasingly Looking to Used Vehicles to Help Offset a Decline in New Vehicle Sales

Many OEMs and lenders are concerned about the large increase in supply of used cars that will be hitting the market in the next few years. But retailers are looking at the increasing supply as an opportunity to sell more used cars to offset the decline in their new vehicle departments. And for many franchises, dealers get higher profits on used units than on new units. Plus, some dealers who complain that their stair-step levels for new vehicles are set too high are choosing not to chase their targets, particularly as sales decline. They will focus on higher grosses in their new vehicle department, and higher sales of used, and then in the following year their stair-step targets may be set lower and therefore would be easier to achieve.

Dealership Values Have Likely Peaked

We believe we have passed the peak in terms of blue sky multiples and blue sky values, barring any significant tax cut for pass through entities which we discuss on Page 13. We estimate that the average blue sky multiple for all franchises on an unweighted basis was 4.82x in Q1, unchanged from the end of 2016. But profits have fallen so far in 2017 and this leads to a decline in the average dealership value. Applying the 4.82x blue sky multiple to the average dealership pretax profit of $1.437M over the last twelve months generates an average blue sky value of $6.92M, down 2.0% from year end 2016. As long as current trends continue, dealership values are likely to decline slowly for the foreseeable future barring a big change in the tax code.
For most of 2016 the public retailers underperformed the S&P 500 Index by about 20% as investors became concerned about the sales cycle and believed other industries had better prospects. Their values fell much more than the decline that we saw in the value of private dealerships. After the election there was a brief rally in these stock prices that narrowed the gap to around 10% of the S&P 500 performance, but the public retailers have since fallen to an even larger 33% gap from the S&P 500 since they released their 2016 year-end and Q1 numbers. Year to date, the public retailers stock price has fallen 10.6% and but is up 6.5% over the past 12 months, both lagging the S&P 500.

Kevin is joining Haig Partners after almost 30 years of commercial banking experience, including 20 years at Bank of America’s dealer financial services group. He served many of the Top 150 dealer groups, including all of the public retailers, as well as numerous smaller dealers across the US. Kevin and his team of senior bankers managed the largest portfolio of loans to auto dealers of any commercial bank. Because Bank of America is a leading blue sky lender, Kevin has been involved in well over 100 buy-sell transactions. He has a keen understanding of how dealerships are valued and the way transactions are structured. Kevin’s former clients described him as a trusted advisor who provided expert advice that helped them to build the value of their companies. Long one of the leading commercial bankers to dealers across the US, Kevin will bring that results-driven, client-centered focus to Haig Partners.

Kevin holds a BA in Business Administration from Taylor University. He lives in Jacksonville, FL with his wife and three children.

KEVIN’S CONTACT INFORMATION:
904-234-0008
Kevin@HaigPartners.com

“I am thrilled and honored to be joining Haig Partners, which I have long considered the industry’s leading advisor to clients pursuing a dealership acquisition or divestiture strategy.

I have witnessed numerous times how effectively Haig Partners has represented its clients to maximize the value of their dealership and pursued flawless execution on their behalf.

I look forward to complimenting this tremendous team in support of our dealer clients.”

– Kevin Nill
BUY SELL TRENDS AND EVENTS

Buyers Are Pickier

Buyers are telling us they are more selective given where we are in the auto cycle. They want stores that fit all aspects of their acquisition strategy in terms of location, franchise, and operating performance and they have more deals to choose from. Pricing remains healthy for attractive dealerships, but dealerships that have a lot of “hair” on them such as facility issues, unions, or incoming add-points will need to be priced a good bit lower than comparable deals in the market to get the attention of buyers. And since profits are likely to trend down, which would likely push dealership values down, time may work against the interest of sellers. An overpriced dealership will sit until its owners adjust their price expectation, and offers in the future may be lower than what they are currently.

Sales of Dealership Groups Fell, But Will Likely Recover

Buyers purchased 60 groups in 2016 compared to 51 groups in 2015, an uptick of 17.6%. But so far in 2017 the sales of dealership groups fell 48% from the same period in 2016 from 21 to 11 groups. We expect the sales of dealership groups will accelerate in the remainder of 2017 given the level of supply that we see in the market, and the growing realization on the part of many sellers that they will have to accept their current offers or retain the dealerships for at least several years more until they increase in value again. In fact, Lithia CEO Bryan DeBoer said in his Q1 2016 earnings call, “The opportunity to consolidate dealerships has never been greater.” Plus, lenders remain bullish and are willing to provide substantial debt for buyers.

Public Companies Are More Focused on Other Investments Than Franchised Dealership Acquisitions

Only Asbury and Penske made acquisitions of US auto dealerships in Q1 2017, while AutoNation spent a few million dollars on a collision center. The $285M spent on US acquisitions in Q1 by Asbury and Penske is misleading as much of this was for stand-alone used car stores and collision centers. The public companies increased their spending on truck related businesses, foreign based dealerships, real estate and other investments from $271M in Q1 2016 to $358M in Q1 2017. Despite low share prices, share repurchases were insignificant in Q1 2017. AutoNation has announced it will be making major investments in used car dealerships, auction houses, collision centers and private label parts, so its capital will be limited for acquisitions of franchise dealerships. Sonic and Asbury have not announced any big acquisition plans. Penske has become active again in the US market on the luxury side. Lithia is likely to be the most active acquiror again in 2017 as it seems to have the field to itself.
A Tax Cut Could Be A Win-Win for Buyers and Sellers

The Trump administration’s recent proposed tax plan included a provision for pass through entities that would cover most dealerships. For states with no income taxes, the after-tax income to dealers would jump from approximately 65% (per TaxACT.com) to 85%, an astonishing increase of 31%. These changes should make dealerships much more valuable. If the benefits of a tax cut accrued only to the benefit of buyers (holding purchase multiples constant), they would see their after-tax returns on investment increase from 12.0% to 14.9% in unlevered acquisitions. Conversely, if the potential benefits of a tax cut accrued only to the benefit of sellers (holding returns constant to the buyer), they would see blue sky values per store increase 32% over current estimated levels. The likely outcome is that the buyer and seller would share the benefits of the tax cuts with sales prices going up to sellers and returns increasing for buyers.

The Trump tax proposal also called for a reduction in capital gains taxes from the maximum 23.8% to 20% which would allow a seller to keep more of the proceeds from a sale. This change alone would still be helpful in getting more agreements between buyers and sellers since sellers will keep more of the proceeds.

Potential Returns on Investment When Factoring in a Recession

In the analysis above, we show basic Return on Investment calculations on acquisitions that assumed cash flows would remain constant over time. We thought it might be useful to show how some dealership buyers view the potential returns on investment from acquisitions over a ten-year period that include a recession using an internal rate of return calculation (IRR). We looked at three basic scenarios to consider a range of possible outcomes from an acquisition of dealership for 4.82x earnings (our current average blue sky multiple) plus assets equal to another year of earnings, for a total investment cost of 5.82x earnings.

**Scenario 1 - Growth:** Profits increase by 15% over three years, then a recession occurs in which profits fall 20% below their peak, and then profits return to peak before a sale in Year 10 for the same multiple paid. This scenario might apply to an acquisition of an underperforming dealership.

**Scenario 2 - Flat:** Profits remain the same for two years, a recession occurs in which profits fall 20% below their peak, and the profits return to original levels before a sale for the same multiple paid in Year 10.

**Scenario 3 - Decline:** Profits fall 20% and never recover. Sale occurs in Year 10 at a multiple 1x lower.

The following table shows the projected pre-tax cash flows and Internal Rates of Return from these acquisitions on an unleveraged and leveraged basis. The leveraged scenarios assume a 10-year loan of 50% of the total purchase price at a rate of 4%.

### IF ALL POTENTIAL BENEFIT GOES TO BUYERS

<table>
<thead>
<tr>
<th></th>
<th>Pre-Tax ROI</th>
<th>ROI @ Current Tax Rates</th>
<th>ROI @ Proposed Tax Rates</th>
<th>% Increase in After-Tax Cash Flow</th>
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</thead>
<tbody>
<tr>
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<td>17.2%</td>
<td>12.0%</td>
<td>14.9%</td>
<td>24%</td>
</tr>
<tr>
<td>Leveraged</td>
<td>20.0%</td>
<td>13.4%</td>
<td>18.2%</td>
<td>35%</td>
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</tbody>
</table>

### IF ALL POTENTIAL BENEFIT GOES TO SELLERS

<table>
<thead>
<tr>
<th></th>
<th>Multiple @ Current Tax Rates</th>
<th>Multiple @ Proposed Tax Rates</th>
<th>Incremental Blue Sky Value</th>
<th>% Increase in Blue Sky Value</th>
</tr>
</thead>
<tbody>
<tr>
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</tr>
<tr>
<td>Leveraged</td>
<td>4.82x</td>
<td>6.06x</td>
<td>$1,782k</td>
<td>26%</td>
</tr>
</tbody>
</table>

*Note: Assumes purchase at average blue sky multiple of 4.82x plus 1x for working capital and other assets. Leveraged scenario assumes a 10-year amortizing loan for 50% of purchase price at 4% interest.*
As seen in the tables above, dealership valuations remain healthy because they provide a return to buyers that exceeds almost any other kind of investment available on the market today, so long as they expect to hold the investment for ten years or more.

**Buyers Are Shifting Their Focus From Luxury Stores to Domestic Stores**

The US auto market has shifted quickly in the past 18 months from cars to trucks. This shift has hurt a number of the luxury and midline import brands that found themselves with the wrong mix of vehicles at dealerships, hurting profits. Dealership buyers have taken notice as sales of luxury dealerships fell 21% in 2016 compared to 2015 and another 56% in Q1 2017. Sales of import dealerships fell by 25% in 2016 but only by 23% so far in 2017. The shift has benefitted the domestic brands that have traditionally been weighted towards trucks and SUVs. Buyers follow the money and they acquired 31% more domestic stores in 2016 than in 2015, though volumes are off 20% for this segment so far in 2017 along with the market. Domestic brands would have seen a bigger increase in their blue sky multiples, but there are some ten thousand domestic dealerships that operate in the US, so buyers have numerous options to acquire domestic stores without paying a large multiple. The tables below show how the mix of acquisitions has shifted over the past year, and also how the multiples of premium luxury brands, domestic brands, and midline import dealerships have changed over the past year.
We have been involved in the purchase and sale of more than 270 dealerships in our careers dating back to 1996. In the past three years, Haig Partners has been involved in representing buyers or sellers of Aston Martin, Audi, Bentley, Cadillac, Chevrolet, Chrysler-Jeep-Dodge-Ram, Ferrari, Ford/Lincoln, Honda, Hyundai, Infiniti, Jaguar/Land Rover, Kia, Lexus, Maserati, Mazda, Mercedes-Benz, Nissan, Porsche, Subaru, Toyota and VW dealerships. 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.

Dealership Valuation Methods

Although there are various ways to value dealerships, we will refer to the traditional method of combining blue sky (calculated as a multiple of adjusted pre-tax profits), plus the value of other assets acquired. Pre-tax income should exclude non-recurring income or expenses and properly reflect the market value of any real estate owned by the seller and leased to the dealership.

The blue sky multiple ranges that we set forth in this report reflect our expectations what buyers in competitive situations will pay for the goodwill of dealerships and we note any upward or downward changes from Q4 2016. We remind the reader that each dealership transaction is unique and dealerships may trade above or below the ranges we describe in this report. Dealerships that are underperforming or are in highly desirable markets may have higher values. One buyer of a Toyota dealership recently informed me he paid over 12x adjusted pre-tax profit for a large Toyota store since he believes it will make significantly more money in the future. Conversely, dealerships that are in less desirable markets, are overperforming or that have significant real estate issues may bring lower multiples.

Luxury Franchise Blue Sky Multiples

Porsche. Porsche outperformed the market, growing 4.9% in 2016 and another 3.4% so far in 2017. Despite higher sales, there was a staggering 91 days supply as of May 1, far higher than normal, which could put pressure on margins and floorplan expense. But Porsche stores are rare, and dealers tell us they are highly interested when they come to market. Same multiple range: 7.5x-9.0x.

Mercedes-Benz. M-B finished even with the market in 2016 and is off to a good start in 2017, up 0.8%. M-B outperformed Lexus and BMW in both periods. M-B dealerships are capable of generating high levels of profits and dealers are pleased with M-B's leadership. Its recent commitment on facility standards should also be viewed as a positive, allowing dealers time to earn a better return on their investment. One negative of the brand is that they continue to add new points that hurt the local dealers. We have been involved in the sale of five M-B stores recently and demand has been strong. Same multiple range: 7.0x-8.0x.

Lexus. After a nice 2015, Lexus fell 3.9% in 2016 and is down a staggering 15.3% so far in 2017 with no models posting a gain. We are hearing that Lexus is losing thousands per unit on its lease returns due to residual values that were set too high in 2014 and 2015 so it has backed off leasing, with scary effects as these customers are defecting to other brands. Lexus is also adjusting to the shift from cars to trucks. Inventory stood at 92 days on May 1! That said, dealers still love Lexus and it came in first in “Value” in NADA's Summer 2016 Dealer Attitude Survey. We were involved in the sale of two Lexus stores in 2016 and interest was very strong. Same multiple range: 7.0x-8.0x.

BMW. So far in 2017, BMW is slightly ahead of the market and inventories appear to be much healthier than in 2015 and 2016. Dealers tell us they are playing fewer games with their loaner fleets that in the past were used to inflate sales above true demand for new units. Dealers are still short CUVs and most of its CUV models are aging compared to the competition. The new 5 Series is off to a good start but inventories are tight. With key redesigns coming in MY 2018 and 2019, we expect BMW dealers will gain back share and boost profits. Facility upgrade requirements continue to be a challenge for some dealers, and these requirements can suppress franchise value. Despite its recent issues, acquisition opportunities for BMW stores are rare, so buyers remain highly interested whenever one becomes available. Same multiple range: 6.5x-8.0x.
Audi. Audi continues to grow faster than the market with sales increases of 11% in 2015 and 4% in 2016. In the first 4 months of 2017, Audi is up 7.7%. Audi’s SUV factory in Mexico opened in September to produce the new Q5, which will further lift Audi’s production of higher margin CUVs that have been in limited supply. Audi has largely worked through an excessive amount of car inventory that was suppressing margins and has altered its Business Plan Objective system to make it easier for dealers to achieve bonuses. We have also heard they will be reducing the costs of their loaner car program and making other changes to address dealer complaints of low profits compared to other luxury brands. Same multiple range: 6.5x-7.5x.

Jaguar-Land Rover. JLR is up 23.7% so far in 2017 with Jaguar up 140% (thank you XE and F-Pace!). However, inventory crept up to 75 days on May 1. The blue sky multiples for JLR are hard to determine at the moment since the factory is exerting leverage on stand-alone Jaguar and Land Rover dealers to combine while also adding a large number of add-points. We are seeing transactions where the buyer is paying an exorbitant price for the sister brand but getting a JLR add-point in a contiguous or distant market as a reward. The dealers that don’t combine may see an add-point given to a third party, which will hurt both existing dealers. For combined JLR stores where no add point is coming, same multiple range: 6.0x-7.0x.

Cadillac/Acura/Infiniti. Cadillac sales were down 3% in 2016 and another 1.3% so far in 2017. New products (CT6 and XT5) launched into highly competitive segments have not helped performance and there is no new product until MY 2019. Inventory stood at 108 days on May 1, obviously not good for a luxury brand. Acura underperformed in 2016 and so far in 2017, down 8.9% and 15.1%, respectively. Acura CUVs have fared ok but cars are declining significantly. Inventory was 85 days on May 1, far too high for a franchise with limited models. Infiniti is a different story, up an impressive 26.1% so far in 2017 (even cars were +7.3%). Infiniti has done a much better job than Acura at creating differentiated products with distinctive styling at affordable prices. These near luxury franchises have a hard time making over $1M in most markets, but they can provide nice tuck-in acquisitions. Same multiple range for this group: 3.0x-4.0x.

Volvo. After an impressive 2015 and 2016, up 24% and 18%, respectively, Volvo is down 8.6% so far in 2017. The new XC60 should help restore Volvo’s momentum. It will take time for fixed operations to recover as units in operation have likely fallen to the lowest level in decades. Nevertheless, the franchise is alive and might be an excellent value if Volvo continues to launch attractive new products and gain back the share it lost. It still has many loyal customers. Same value range: $1,500,000 - $2,000,000.

Mid-Line Import Franchise Blue Sky Multiples

Toyota. Toyota sales are down 4.5% so far in 2017. Truck and CUV sales are healthy but not enough to offset a steep decline in cars and inventories are higher than normal. RAV4 is likely to become the highest selling Toyota this year displacing Corolla and Camry that have dominated all models for decades. Toyota has more new products coming than any OEM over the next few years according to Bank of America’s Car Wars Report, making it likely it will be gaining some share. However, launches in MY 2018-2019 are car heavy; significant new trucks and SUVs don’t arrive until MY 2020 and 2021. High profits per store and a dealer-friendly OEM continue to attract lots of buyers. Same multiple range: 5.0x-6.5x.

Honda. Honda sales grew 4.8% in 2016 and another 1.2% so far in 2017. As a sign of the times, the CR-V was the best-selling Honda, beating out Accord and Civic. Loyal customers and a balanced business model of strong variable and fixed operations continue to attract buyer interest. Dealers love the predictability of the Honda business model. However, inventory currently stands at 70 days, far higher than recent levels and its product replacement over the next 3 model years is more car heavy than peers. Same multiple range: 5.0x-6.5x.

Subaru. Subaru’s sales growth continued in 2016 with sales up 5.6% and another 7.6% through April 2017. Dealers love Subaru, and it came in second in “Value” in NADA’s Summer 2016 Dealer Attitude Survey. With a product lineup that is geared towards CUVs, Subaru continues to take share from its larger Japanese and Korean rivals. Same multiple range: 4.0x-5.0x (with pricing higher in Snow-Belt states).
Kia. Sales were up 3.5% in 2016 but are off 10.7% in 2017 as the previously best-selling Soul was down 26%. This franchise can provide a high ROI to buyers as the multiple is relatively low and real estate costs are less than most other brands. We hear some reports that the factory can be aggressive towards dealers it sees as underperforming. Same multiple range: 3.25x-4.25x.

Hyundai. Sales beat the market in 2016, gaining 1.7% but are down 4.4% through April. The company is shifting its supply of CUVs from other markets to increase availability. Expect new CUV products in MY 2019 and beyond as well. This move should benefit retailers along with the much higher units in operation that are starting to show up in dealers’ service departments. Same multiple range: 3.0x-4.0x.

Nissan. Sales were up 5.5% in 2016 and 0.7% through April although the sales growth has been through fleet instead of retail sales. Inventory crept up to 78 days on May 1. Dealers still complain about Nissan and gave it poor ratings in NADA’s Summer 2016 Dealer Attitude Survey. But dealers who have consolidated markets seem to be doing very well and enjoying a strong return on investment. Though Nissan has benefitted from a relatively fresh product lineup recently, MY 2018 and 2019 have almost no truck or SUV launches. Same multiple range: 3.0x-4.0x.

Mazda. After declining 6.7% in 2016 due to a car heavy portfolio, sales are up 2.6% so far in 2017, largely due to the CX-9. Mazda has been underweighted in trucks and CUVs and that has cost them sales in this environment of cheap gas. Same multiple range: 3.0x-4.0x.

VW. For the first time in quite a while, VW dealers are seeing increased sales, up 7.7% in 2017 so far. Some of this lift is unfortunate as it is thanks to customers coming to dealers to hand in their diesel vehicles in return for substantial cash payments that they are using to buy new VWs. But a good number of these customers are defecting and taking the cash payments to other dealers down the street. Many of these diesels will end up being scrapped, which will reduce the number of units in operation. Finally, VW is getting some fresh CUV products in the Atlas and a new Tiguan that it desperately needs to move its sales mix from 43% truck/CUV towards the industry average of 60% (and growing). Higher CUV sales will also help improve new vehicle gross profits given the low margins on VW cars. Now that we are past the worst, we would expect an uptick in buyer appetite for this franchise. Same value range: $500,000 - $2,000,000.

Domestic Franchise Blue Sky Multiples

(Note: The multiples paid for domestic franchises will likely be higher in markets like Texas where trucks sell well and lower in markets like California where imports dominate.)

Ford. Ford sales declined 0.6% in 2016 and another 5.6% so far in 2017. We are perplexed why Ford would be losing share given its product mix should be an ideal fit for today’s environment of low gas prices. Ford has a significant number of SUV and truck launches over the next three model years that should help sustain share. We have been involved in the purchase or sale of eight Ford dealerships recently. All got significant interest from buyers. Same multiple range: 4.5x-5.5x.

Chevrolet. With GM’s pivot away from fleet sales, Chevy was down 1.4% in 2016 and another 3.1% in 2017. Consumers are attracted to its truck/CUV/SUV heavy lineup and GM has many of these products it will be releasing in upcoming years that should help it gain share, especially new full-size pickups and SUVs in MY 2019 and 2020, respectively. Some dealers are worried that a mature sales environment will make it increasingly difficult to qualify for GM’s EBE/SFE incentive programs and they are hoping GM will modify this program. Same multiple range: 3.75x-4.75x.

FCA (Chrysler-Jeep-Dodge-Ram-Fiat). FCA’s sales were even with the market in 2016 but were driven by a 10% increase in fleet sales. So far in 2017, sales are down 8.2% with only Ram showing an increase. FCA’s inventory is the lowest among the domestics suggesting they have adjusted production better than rivals. Some buyers love this franchise, while others are wary of FCA’s long-term prospects. We are a concerned about the idea of putting Jeep into a separate showroom. Their ability to maintain market share with little new product recently
and the discontinuation of their small car platforms is impressive. Truck and SUV heavy launches in MY 2018-2020 should help them maintain share but expect much lower share in cars over this time period. Same multiple range: 3.25-4.25x.

Buick-GMC. Sales were down 0.7% in 2016 even as GM pulled back on fleet sales. In 2017, sales are up 4.7%. GMC continues to perform well with its pick-up trucks and SUVs, particularly the new Acadia. However, Buick-GMC inventory is the highest among the domestics. Its Denali sub-brand is increasingly popular with truck and SUV buyers who are seeking premium products and are willing to pay steep prices for decked out vehicles, providing fat margins for dealers and GM. This should continue with new full size pickups and SUVs coming in MY 2019 and 2020, respectively. Dealers have the same EBE/SFE concerns as Chevrolet dealers but the ongoing shift to trucks and SUVs should help this franchise more than most. Same multiple range: 3.5x-4.5x.

SUMMARY

Most auto industry analysts and leaders of large dealer groups seem increasingly convinced that the market has peaked, but that we are likely to continue to see healthy profits at dealerships for the remainder of 2017. With slowing sales and falling vehicle margins dealers will need to focus on expense control to maintain profits. The buy-sell market remains active, although down substantially so far this year. We see public companies, privately owned dealership groups and investors all looking for transactions that fit their strategies, but pricing has fallen slightly. Tax reform would boost the value of dealerships and help stimulate transactions.

Haig Partners is seeing these conditions in our current engagements that range from Florida to New York to California. These transactions include domestic, import and luxury dealerships. We know of no other firm that has a better understanding of the perspectives of both buyers and sellers of dealerships across the US, and we use this perspective to negotiate highly desirable outcomes for our clients. The value of the transactions that we have closed over the past two and a half years is over $900M, excluding new vehicle inventory values, which works out to be over $50M per transaction and $25M per dealership. We served as the advisor on two of the largest transactions in 2016, but we also are pleased to work on smaller transactions where we feel we can add value to the sale process.
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- Costs begin to eat into dealership profits
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- Buyers are plentiful, but choosier
- Buy-sell activity drops 29% in Q1 2017, perhaps due to Presidential election and an abnormally active Q1 2016
- Buy-sell activity for the remainder of 2017 is expected to increase from Q1