Let's Enjoy the Ride

It seems increasingly likely that we have hit an inflection point in auto retail where sales and profits have leveled off, albeit at a high level. The last six years made all of us in the auto industry look pretty talented. In the words of Woody Allen, 98% of our success came from just showing up: sales rose, profits rose, dealership values rose. Now we will all have to work harder to maintain the good fortune that we have had. Although we will miss growth, data reminds us that the current environment remains a veritable Cloud Nine with strong vehicle sales, excellent fixed operations, low interest rates on bountiful debt, and record high profits per dealership. And with few signs of a recession, dealers are still interested in buying dealerships, although more cautiously than in the past as they no longer expect growth to enhance their returns. This sentiment is reflected in the buy-sell data for the second quarter. While public companies continue to suffer from low valuations and are allocating most of their excess cash to stock buy-backs, private dealers are looking for stores to buy as they are generating lots of cash and acquisitions still appear to provide them with a high return on investment. As a result of these factors, dealership values remain strong and we expect buy-sell volume will remain high for the foreseeable future.

The Buy-Sell Market Remains Active

The total number of dealerships purchased by public and private dealers through June 2016 was essentially unchanged from the same period in 2015, excluding the Berkshire Hathaway acquisition of Van Tuyl. The number of dealerships acquired by private buyers in the first half of 2016 was down 3% from the first half of 2015. This decline is slight, but it could signal that the market has reached a peak in terms of buy-sell activity after several years of strong growth.

Dealership Acquisitions - The Banks Report

Public companies remain hunkered down for the most part. Asbury, Group 1, Lithia, and Sonic did not spend a dollar on acquisitions in the US for the second consecutive quarter. AutoNation acquired a CJDR store in Denver and Lithia purchased a Buick GMC store in Montana. Also unchanged from Q1 is the deals done by the public retailers comprised just 6% of the transactions in Q2 2016, down from 9% in Q2 2015. While AutoNation acquired a luxury group in July and the other publics have said they are seeking acquisitions, we expect the remainder of 2016 to be less active for them than in 2015 due to their preference for allocating their capital to stock buy-backs when their stocks are trading at low multiples. The following chart shows that the amount of spending by the publics on acquisitions is essentially flat from the first half of 2015 to the first half of 2016.
Blue Sky Multiples Remain Strong

We continue to see significant demand for dealership acquisitions by private buyers. Strong sales of high margin trucks and SUVs are boosting profits at domestic stores and interest from buyers. Key midline import franchises like Honda and Toyota are selling lots of vehicles and have a highly predictable business model. Due to these factors, we see stable multiples for most mid-line and domestic franchises. The outlook for premium luxury brands is a little cloudier. The demand for these franchises skyrocketed in recent years as they outperformed the overall auto industry in terms of sales growth, margins and profits per store. In late 2015, however, a number of events happened around the same time that caused profits to fall at luxury stores for the first time in many years. Some buyers began to question why these franchises should bring valuations that were so much higher than non-luxury franchises. In fact, we reduced blue sky multiples for Audi and BMW in our Year End 2015 Haig Report, and are reducing the multiple slightly for Mercedes-Benz in this quarter. We expect some of these concerns will be mitigated by the actions luxury automakers are taking (cutting production, shifting from cars to trucks, providing more airbags for recalled vehicles, etc.) to restore margins and profits. And one factor that will remain constant is that there are still relatively few premium luxury stores, so when they come available some buyers will stretch on price with the belief that they will be attractive long term investments. Despite recent challenges in the premium luxury segment, we have seen only minimal movement in the prices of these stores.

The table below provides our estimate of what multiple of adjusted pre-tax profit a buyer participating in a competitive sales process (i.e. not the only buyer at the table) will 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. 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 or have facility issues will bring lower multiples. Underperforming dealerships can bring much higher multiples. Metro stores typically bring higher prices than stores in rural areas. In other words, each store is unique and brings its own set of opportunities and challenges. And geography matters a great deal. For instance, a Ford store in Texas is likely to bring a premium price compared to a Ford store in California. We caution readers not to view these values rigidly.
TRENDS IMPACTING AUTO RETAIL

Conditions Are Mostly Positive

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

- **GDP is Growing, But Barely.** Q1 Real GDP growth was revised down to 0.8% from 1.1% and Q2 GDP growth has been initially reported at 1.2%, well below expectations of 2.5%. While still positive, these rates are lower than what many economists expected.

- **Interest Rates Remain Low.** The average cost for a five-year auto loan was 4.2% per Bankrate.com, down slightly from levels seen since late 2015.

- **Employment and Household Income Are Increasing.** The US added over 1M jobs so far this year, keeping unemployment down to 4.9-5.0% overall, and 2.5% among college graduates. Real disposable income per capita was up 2.3% in Q1 and 1.6% in Q2.

- **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 3.3% through May 2016 compared to the same period last year, according the US Federal Highway Administration.

- **Gas Prices Remain Low.** The Department of Energy reported that the average price per gallon of fuel was $2.09 over the first seven months of 2016, down from $2.43 in 2015 and a high of $3.62 in 2012. Annual savings on gas will exceed $600 compared to a year ago.

- **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.

There are, however, a couple of indicators that are headed in the wrong direction and are giving some dealers concerns about the future:

- **Inventory Levels Are Elevated.** Due to increased production, declining growth in the rate of new vehicle sales, and stop-sale orders due to recalls, inventory levels are higher than normal and putting pressure on gross margins.

- **Used Car Pricing Is Declining.** NADA’s Used Vehicle Price Index was down about 4% for Q2 and is at the lowest levels since 2011. Lower used car prices can affect new vehicle sales as they make it more difficult for owners to trade in their vehicles for new ones. Also, lower residual values on used cars will likely drive up the costs of auto leasing. The high number of units subject to stop-sales for airbags and other recalls are also hurting used car departments.

- **Incentive Spending Increasing.** Incentive spending through June increased 13% Y/Y per Autodata, raising the concern that true demand for vehicles is weakening.

- **Profits at Some Dealers Are Declining.** Per NADA, profits for the average privately owned dealership fell during the past twelve months ended in May compared to the full year 2015. Public company filings that show operating income falling at four of the six publics in the first half of 2016 compared to the same period in 2015.
New Vehicle Sales Remain At All Time High, But Driven by Fleet

After declining in May and June, July SAAR grew 1.6%, keeping hope alive for another record year. Experts are varied in their opinion of the future of new car sales, with estimates ranging from the current level up to 20 million. But the further we progress in 2016, the more it looks as if new vehicle sales (retail and fleet) have little room for growth. Based upon projections from eleven analysts we follow, we show a prediction for 2016 of 17.7M units, which would represent an increase of 1% over 2015, the lowest annual growth rate since the Great Recession.

And while total new vehicle sales have increased slightly in 2016, it is important to note that this increase is due solely to a 10% increase in fleet sales. Both Automotive News and JD Power are indicating retail sales are essentially flat for the first half of 2016 versus the same period in 2015. In fact, as seen in the chart to right, JD Power shows that the US Retail SAAR peaked in September 2015 at 15.3M units and has not yet recovered in the past ten months.

We are still hearing about sales records from some OEMs, but almost all are driven by fleet sales, as evidenced by the table to right that shows big spikes in fleet from some OEMs like FCA, Ford and Nissan, compared to restraint in fleet sales by GM, Toyota, Honda and the Koreans. GM indicated that their retail sales increased 5% in July pushing retail market share to its highest level since 2011.

Grosses May Be Stabilizing

The erosion of gross profit on the sales of new and used vehicles has been a major issue for retailers. According to data published by the public retailers, profits for new units had declined 5.1% from Q1 2015 to Q1 2016, which moderated to a decline of just 1.3%, or $28 per car, in the first half of 2016 compared to the same period in 2015. This means that profits per new car increased during the Q2 2016 compared to Q2 2015 by 2.1%, or $45 per car, something we haven’t seen for several quarters. For used cars, profits fell
TRENDS IMPACTING AUTO RETAIL

4.5%, from Q1 2015 to Q1 2016, compared to a decline of 3.1%, or $53 per car, from Q2 2015 to Q2 2016. We are seeing at least a bit of evidence that stakeholders are aware that dealers need to make a fair profit when they sell a vehicle. Companies like Honda and Toyota have implemented advertising policies that prevent dealers from advertising below invoice. TrueCar is working with retailers to make them more profitable, not just driving down pricing. And some OEMs are adjusting production to better balance supply and demand.

Finance & Insurance Departments Are Generating Record Profits

Gross profits from F&I continue to grow, which is helping to offset lower gross profits per new and used vehicle sold. In the first half of 2016, the public groups reported gross profit per vehicle retailed reached an all-time high of $1,410, up 4.7%, or $63 per vehicle, from the first half of 2015.

Fixed Operations Driving Higher Profits

Almost six years of rising sales have boosted the number of units in operation and these vehicles are showing up in service drives around the country. Also, the big spike in recalls that involve many millions of vehicles is another blessing for service departments. Private dealers reported fixed operations increased 4.2% in early 2016. Public retailers also did well, averaging 4.8% growth on a same-store basis in H1 2016 compared to H1 2015. Higher profits from fixed operations may continue to lift dealership profits even if vehicle sales and/or margins worsen.

Days Supply of New Vehicles Is Still High

The table at right shows the change in days supply from July 1, 2015 to July 1, 2016 for key categories. Domestic and midline import brands are showing elevated levels of inventory which can suppress margins. But note the much higher increase in the days supply for the premium luxury brands, up an average of 23% from 43 days to 53 days during this period. While high, this level is an improvement from earlier in 2016 when days supply for premium luxury exceeded 60 for several months. We hope the OEMs will adjust their production to better meet demand.

Dealership Expenses Are Growing Faster Than Gross Profit

NADA recently published data that showed the average dealership in the US during the year to date May period enjoyed a revenue increase of 2.5%, an increase in gross profit of 2%, but an average increase in costs of 4%. One dealer told us, “All the bad habits are coming back. We are selling lots of cars but getting fat again.” We expect smart dealers will be highly focused on reducing costs in a mature market, and a number of the public companies have announced they have been taking steps to reduce inventory, personnel and other costs.
**TRENDS IMPACTING AUTO RETAIL**

**Dealership Profits Drop**

The net outcome of the trends listed above is that profits at dealerships have declined slightly so far in 2016. Private dealerships generated an average of $1.133M in pre-tax profit over the last twelve months, a decline of 2.9% from 2015. Although it may be too early to know for certain, profits per dealership may have peaked in 2015, as shown in the chart below.

Public companies were basically flat in the first half of 2016 compared to 2015. Their story was similar to private dealers with revenue slightly up, grosses flat and higher expenses. And as you can see in the chart to the right, results were mixed with several public companies off to a rocky start so far in 2016.

**Sales Growth for Individual Franchises**

The following chart sets forth the change in new unit sales at the major franchises in 2016 compared to 2015. In the last few years, almost all franchises were showing sales growth from the prior year, but now we see about as many suffering sales declines as enjoying sales increases. And at least three franchises that show sales gains (FCA, Ford and Nissan) have grown due to fleet sales that do dealers little good. Without fleet, the number of franchises posting sales declines would outnumber the franchises posting sales gains. There are a few bright spots, such as Volvo, Jaguar-Land Rover, Honda, Audi and Porsche, but key luxury brands such as Mercedes, Lexus, and BMW that were beating the market over the past few years are underperforming the market. Sadly, Volkswagen and MINI continue to struggle badly.
BUY SELL TRENDS

Dealership Values May Have Peaked Along with Blue Sky Multiples

We estimate that the average blue sky multiple for all franchises on an unweighted basis was 4.79x in Q2, a tiny drop from Q1 2016 and a decline of almost 1% from the Q3 2015 average multiple of 4.84x. While there is no way to know how accurate our estimates are, we believe we have passed the “peak” in terms of blue sky multiples, and now possibly blue sky values. The average profit per dealership according to NADA has declined slightly for the last 12 months ended May 2016 from year-end 2015. Applying the 4.79x blue sky multiple to the average dealership pre-tax profit of $1.133M over the last 12 months through May 2016 generates an average blue sky value of $5.43M, down 3.1% from year end 2015. Dealers who are considering an exit over the next year or two should be aware that if profits fall by, say 10%, and the average blue sky multiple should also fall by 10%, then the average dealership’s value would fall by 19% from current levels.

While we estimate the value of privately owned dealerships has only dropped slightly, there has been a big sell off in the value of the public auto retailers. The average stock price for public retailers was $50.90 per share on August 18, 2016, 33% below their peak, reached in the summer of 2015, and down 18% from the end of 2015. Investors remain concerned that we have reached a plateau in sales and that overproduction by the OEMs could erode the profits of dealers. The average Price/Earnings per Share multiple has collapsed from 18.4x at the end of 2014 to 11.2x on August 18, 2016, and now trades far below the 25.2 Price/Earnings multiple of the S&P 500, meaning that investors see much less upside from auto retail than they do from the general economy.

Public Companies Have Less Interest in Acquiring US Auto Dealerships

Excluding AutoNation’s acquisition of Allen Samuels Auto Group that was negotiated in 2015 before its stock price fell, the value of acquisitions completed by the publics in H1 2016 in the US was only $25M compared to $300M in H1 2015. Most of the public companies reiterated in their Q2 earnings calls that share repurchase remains more attractive than most acquisitions at their current valuations and executed significant share repurchases throughout Q2. For the remainder of 2016, the publics may close on a number of tuck-in acquisitions but we believe they will be much less active than in prior years. The following chart shows the strongly correlated relationship between the level of acquisition spending and Price/Earnings Ratios for the public companies. (Note: Data excludes Berkshire Hathaway since it does not report results from its auto division.) And the other chart shows that the public companies have increased their share purchases from $309 million in H1 2015 to $1,067 billion in H1 2016, an increase of 245%. In 2014, the bulk of their excess cash was spent on acquisitions. It is important to note that share repurchase is still a form of investment by the public companies and indicates that they remain bullish on the industry.

1 Per Standard & Poor’s
Potential Returns on Investment in a Mature or Declining Market

In our past reports, we have shown simple 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. We looked at three basic scenarios to consider a range of possible outcomes from an acquisition of dealership for 5.0x earnings (slightly above our current average blue sky multiple) plus assets equal to another year of earnings, for a total investment cost of 6.0x earnings. We assume the dealership real estate is leased.

- 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 for three years before a sale for the same multiple paid.
- 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 for five years before a sale for the same multiple paid.
- Scenario 3 - Decline: Profits fall 20% and never recover. Sale occurs in ten years at a multiple 1x lower.

The table below 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%. Note the IRRs range from a low of 12.3% in Scenario 3 to 29.9% in Scenario 1. These returns far exceed the kinds of returns available to dealers from other investment options that they typically have.

We further thought our readers might be interested in the kind of projected after-tax returns that are available to dealership buyers. The amortization of goodwill is another positive feature of acquiring dealerships compared to other investments as it substantially reduces taxes. Assuming a maximum personal tax rate of 44.6% (39.6% Federal and 5% state tax rates), the after-tax, unleveraged IRR under Scenarios 1-3 ranges from 7.4% to 13.0%. The after-tax leveraged IRR under Scenarios 1-3 ranges from 10.3% to 18.8%. We even ran a scenario with leverage where cash flows fell 40%, and an investor could still get a 5% IRR after-tax. Not bad for a disaster scenario!

Regardless of the math a buyer uses, 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. And remember, if we experience any amount of inflation over the next ten years, these returns would be even higher.
We have been involved in the purchase and sale of 262 dealerships in our careers dating back to 1996. In the past two 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 Q1 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, while dealerships that are in less desirable markets, are over-performing or that have significant real estate issues may bring lower multiples.

Luxury Franchise Blue Sky Multiples

**Porsche.** After a strong 2015 with sales up 10%, Porsche only grew 2% so far in 2016, largely due to a decline of 18% in July. Porsche attributes this to inventory shortage on the Macan and Cayenne due to the model year changeover which seems plausible given the increase in the brand’s sports cars. Per unit gross profits have declined from their stratospheric heights due to increased inventories and a higher mix of lower priced/margin Macans. Given the significant growth in units in operation, we expect dealers will soon be enjoying a boom time in fixed ops. Along with this growth, buyers should expect to expand any facilities they acquire. Porsche stores are relatively rare, and dealers tell us they remain highly interested when they come to market, particularly in metro markets in which they can earn strong profits. Same multiple range: 7.5x-10.0x.

**Mercedes-Benz.** M-B is off to a tough start in 2016 with flat sales and declining margins despite its best product lineup ever. Perhaps the new E-Class will help it regain share. Dealers were complaining of too much inventory and weak margins at the beginning of the year, but those challenges appear to be waning. M-B dealerships remain much in demand as they are capable of generating high levels of profits and dealers are pleased with M-B’s leadership. We have been involved in the sale of four M-B stores recently and demand was strong. Buyers are telling us that while they still want MB stores, but they are slightly less bullish than in the past. Lower multiple range: 7.5x-9.5x.

**Lexus.** Lexus had an excellent year in 2015 but is off to a slow start in 2016, declining 5.0% through July. Dealers love Lexus and it came in first in “Value” in NADA’s Winter 2016 Dealer Attitude Survey. Parts and service departments are growing strongly now that units in operation have increased so much over the past five years. But dealers are complaining about stale products and low margins right now. One even questioned if he was in the luxury business as he was making more off the sale of a used Chevy truck than a new Lexus. We were involved in the sale of two Lexus stores recently, and interest was very strong. Same multiple range: 7.5x-9.0x.

**BMW.** BMW underperformed the market in 2015 and declined 8% through July. BMW is now trailing Lexus and Mercedes in unit volume. One source told us BMW ran into a trifecta of issues around the end of 2015: slowing sales, a shift in the market from cars to trucks, and a significant number of stop sales due to the Takata airbag problem. This source said BMW had cut overall production, shifted its mix towards SUVs and that many airbags are now
arriving so that inventories were headed back to historical levels. As such, we would expect profits to rise at BMW stores in the back half of 2016. Facility upgrade requirements continue to be a challenge for some dealers, particularly in smaller markets. Despite its recent issues, acquisition opportunities for BMW stores are rare, so buyers remain highly interested whenever one becomes available. Same multiple range: 7.0x-9.0x.

**Audi.** Audi continues to grow faster than the market with sales increases of 11% in 2015 and 4.0% through July 2016. Customers love the new Q7 and Audi’s SUV factory in Mexico is projected to open in September, which will further boost Audi’s production of higher margin SUVs that have been in limited supply. Audi also is making a mark in customer service, winning first place in a recent JD Power survey. Audi has largely worked through an excessive amount of inventory that was suppressing margins, and has altered its Business Plan Objective system to make it easier for dealers to achieve bonuses. Issues at VW may cause the parent company to invest even more in Audi in its quest for becoming the leading luxury brand. We hope they will adopt the Lexus model and have fewer dealerships than BMW and M-B, but with higher volumes and profits. Same multiple range: 7.0x-9.0x.

**Jaguar-Land Rover.** JLR was up an amazing 26% (37% for Land Rover alone) in 2015 and another 23% through July. This strength should continue in 2016 with new models at Jaguar, including its first SUV, and a line of lower priced SUVs at Land Rover. These new models should help JLR stores better compete with other luxury brands that have a broader line up of vehicles. However, margins have fallen on Land Rovers due to higher inventory levels and a new margin structure. JLR’s current strategy is for more volume at lower grosses and we hope this will result in more total profit at JLR stores. There are new facility requirements to handle the higher volumes, and JLR is adding dealers in some markets. Same multiple range: 6.0x-7.0x.

**Cadillac/Acura/Infiniti.** Cadillac sales are down 8.0% through July with an aging vehicle portfolio. Johann De Nysschen’s Project Pinnacle’s unspoken intent may be to weed out smaller stores that siphon much needed volume from metro stores. Unless Cadillac dealerships can sell substantially more vehicles per location, its dealer body will never be able to match the luxury experience offered by its German competitors, making it impossible for Cadillac to charge comparable prices. Acura matched the market in 2015 but underperformed significantly through July with a 9.0% decline. Profits per store in some markets remain uninspiring to many buyers. Infiniti was up 14% in 2015 but was flat through July. 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.** With well-received new products, volume was up 24% in 2015 and another 29% through July, a remarkable comeback for a franchise that was fading fast in the US. Its other new products look attractive, and having a deep pocketed Chinese parent will help Volvo to regain some of the market share it has lost over the years. It will also 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 can be a nice tuck-in if facility costs are modest. We upgraded Volvo in our last report. Same value range: $500,000 - $1,000,000.

**Mid-Line Import Franchise Blue Sky Multiples**

**Toyota.** Toyota slightly underperformed the market with 4% growth in 2015 and was down 2.2% through July. This performance surprises us since Toyota has plenty of trucks CUV models, but perhaps they have not yet fully adjusted production to meet the shift in demand from cars to trucks. Dealers have been complaining about declining new vehicle margins, but we are also hearing that Toyota’s new advertising covenants that are designed to support grosses are having some positive effects. Toyota’s high volume/low gross business model continues to be highly profitable for most dealers. High profits per store and a dealer-friendly OEM continue to attract lots of buyers. Same multiple range: 5.0x-6.0x.

**Honda.** Honda sales lagged the market in 2015 with sales up just 2%, but grew strongly through July at 6.9%. Sales are picking up thanks to a barrage of new or redesigned products that should help Honda to take share profitably in 2016. Bank of America / Merrill Lynch’s latest Car Wars report predicts that these updated core products, along with the new models, will make Honda the fastest growing major OEM over the next three years with a replacement rate of 96% compared to the industry average of 80%. 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. Same multiple range: 5.0x-6.0x.
Subaru. Subaru’s torrid sales growth slowed in 2016 with sales up only 2.7% through July. Perhaps it simply ran out of products to ship. Dealers love Subaru, and it came in second in “Value” in NADA’s Winter 2016 Dealer Attitude Survey. We are told Subaru will be boosting production in Q3. With a product lineup that is geared towards CUVs and with advertising that is appealing to Millennials, young families and educated older folks, Subaru continues to take share from its larger Japanese and Korean rivals. Buyers may need to expand dealerships to handle the higher sales and service volume. Same multiple range: 4.0x-5.0x (with pricing higher in Snow-Belt states).

Kia. Sales beat the market, up 8% in 2015 and 5.7% through July. We have been involved with several Kia franchises recently and we have been impressed with the profits that good dealers can generate. We hope Kia can help its dealers build a bigger fixed operations business. 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. Same multiple range: 3.25x-4.25x.

Hyundai. Sales were up 5% in 2015 and beat the market through July at 1.6% growth. The company is shifting its supply of CUVs from other markets to increase availability and recently announced it will launch a light truck in the US. This shift from cars to trucks should help it to maintain or gain share. Same multiple range: 3.0x-4.0x.

Nissan. Sales were up 6% in 2015 and 8% through July. All of the sales growth in 2016 has been through fleet, as its retail sales are flat. We have already described Nissan’s strategy of encouraging “preferred dealers” to consolidate markets in previous reports so we won’t repeat it again. Dealers complain more to us about Nissan than any other franchise and they gave Nissan poor ratings in NADA’s Winter 2016 Dealer Attitude Survey. Dealers who are “winners” in the Nissan system will be buyers of more stores, but we don’t think they will have much competition when bidding for stores. As such, Nissan’s franchise value remains well below its peers. Same multiple range: 3.0x-4.0x.

Mazda. Sales were up 4% in 2015, but have declined 6.9% through July. Mazda has been underweighted in trucks and CUVs and that has cost them sales in this environment of cheap gas. The new CX-9, which is up 41% in July, is going to help. Few buyers seek Mazda as a stand-alone acquisition, but like the returns they can get from them as a part of an acquisition. Same multiple range: 3.0x-4.0x.

VW: Drivers Needed Customers Needed. VW has finally reached a settlement with certain regulatory bodies in the US and will begin to compensate vehicle owners or offer repairs. But it has done nothing to compensate dealership owners who have been left with expensive buildings and collapsing profits. Some customers have abandoned the brand, but another threat is that many VW salespeople are leaving, too. Sales are down 14% year to date. One recent VW customer we spoke with said he almost felt bad for the VW salesman who offered him a $30,000 Passat for $22,000 after speaking for about one minute. There was not even pretense of a negotiation. Litigation will be going on with many parties for years to come, and this will be a major distraction and expense for VW. But we also know that VW has immense financial resources and recently posted extremely high profits despite the crisis. Over time, this scandal will fade from consumers’ minds and the brand will rebound if VW can offer products that US customers want to buy. Maybe there will be a silver lining from this crisis. We are hearing encouraging words that the US division will have greater control over product development and even the names for its products. If Honda can sell a pickup, why not VW? And perhaps we have seen the end of such baffling names such as Eos, Golf, Passat, Tuarag, Tiguan, etc. Bring back the Microbus! We have to think that the bottom is near for this franchise. Buyers willing to stomach short-term losses may find buying a VW store to be one of their better long-term investments. Same multiple range: $0 - $1,500,000.

MINI. We have decided to discontinue our coverage of MINI. Its sales have dropped so much over the past couple of years that they are now an insignificant player in auto retail, below even Mitsubishi. Plus, these dealerships rarely trade hands. With gas prices looking to remain in the $2.00 range, we see a difficult future for the franchise.

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 were up 5% in 2015 and another 3% through July. The bulk of the increase in 2016, however, has been due to fleet sales. Retail sales declined slightly so far in 2016, which surprises us. Ford’s product mix should be an ideal fit for today’s environment of low gas prices, so we would expect them to be gaining share in 2016. Perhaps they moved too far in their efforts to build products that were highly fuel efficient and don’t have the capacity to produce the bigger vehicles that are in demand today. Some dealers are complaining about Ford’s sales incentive...
programs that were rolled out earlier this year. Despite these issues, Ford is seen as the best positioned domestic OEM. We have been involved in the purchase or sale of seven Ford dealerships recently. All got significant interest from buyers. Same multiple range: 4.5x-5.5x.

**Chevrolet.** Sales were up 5% in 2015 but down 5% through July. However, the decline in 2016 is due to a reduction in fleet sales while its retail sales were up as consumers were attracted to Chevy’s product mix of trucks, CUVs and SUVs and its new Malibu. We would expect Chevy to take retail share in this market without resorting to heavy incentives. Perhaps it is short of capacity in trucks. GM posted a record quarter in the US and we have seen some metro Chevrolet dealerships making very high profits. Some dealers still complain about poor leadership. Same multiple range: 3.75x-4.75x.

**FCA (Chrysler-Jeep-Dodge-Ram-Fiat).** FCA’s sales were up 8% in 2015 and another 5% so far through July due to a 34% increase in fleet sales. Retail sales are flat compared to last year. FCA is doubling down on producing more Jeeps while planning to outsource production of low margin cars. Fiat is basically done in this country and FCA’s product quality remains mired in the basement, with seven products ranking last or second to last in the ten product segments in which it competes (Source: JD Power Initial Quality Study 2015). Despite these headwinds, profits per CJDR dealership have been at all-time high levels recently. But with sales leveling off, dealers see FCA’s stair step programs that depend upon higher sales as unrealistic and in need of adjustment. Some buyers love this franchise, while others are wary of FCA’s long-term prospects. Same multiple range: 3.25-4.25x.

**Buick-GMC.** Sales increased 8% in 2015 but were down 2% through July as GM pulled back on fleet sales. GMC continues to perform particularly well with its full sized trucks, SUVS and the new Canyon light truck. GM is thrilled with GMC that it says is one of the most profitable brands in the world from the OEM perspective. Lower gas prices should continue to drive sales of high margin trucks and SUVs. Same multiple range: 3.25x-4.25x.

**SUMMARY**

Although we appear to have reached an inflection point where profits are no longer increasing for the average dealership, the buy-sell market remains highly active. Private dealers have access to lots of capital and are pursuing deals. Publicly traded dealer groups are still active, although less than in the past. And new entrants like private equity firms and family offices continue to work to deploy large amounts of capital buying dealerships. Overall, we see prices about the same for most franchises. We expect the remainder of 2016 to be a dynamic period in dealership buy-sells, although some of the “froth” we saw in late 2015 and early 2016 has probably been blown away.
Haig Partners is seeing these conditions in our recent engagements. By the time this report hits the press, we will have closed on the sale of a Ford-Lincoln dealership in North Carolina to a private group and we are in the midst of negotiations on three other transactions, all with private buyers. The pricing on these transactions has been at or above the ranges for goodwill that we discuss in this report. And we will be soon going to market with several new transactions that range from Maryland to California. These transactions include domestic, import and luxury dealerships. The value of the transactions that we have closed over the past two years is approximately $800M, excluding new vehicle inventory values, which is over $50M per transaction and $25M per dealership. That said, we also are pleased to work on smaller transactions where we feel we can add value to the sale process. 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.

**HAIG PARTNERS:**
**PROVIDING VALUE TO CLIENTS**

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.

**Relationships with Buyers.** We know many of the best buyers across the US and understand what they want to acquire, what their ability is to close, and how they negotiate. By targeting specific buyers instead of running ads, we preserve confidentiality and close transactions more efficiently.

**Higher Prices.** We create offering materials that provide buyers with a compelling investment thesis about why they should acquire our client’s business instead of the other opportunities. We then run a process that creates competition to generate highly attractive offers from buyers.

**Experience.** Since we have been involved in more than 153 transactions with approximately $3.5 billion in value, we know how to respond to issues that can arise in a buy-sell process.

**Speed.** We focus on the transaction every day, allowing owners to focus on dealership operations.

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.*
In the past two years, Haig Partners has guided some of America’s most successful dealers through the sale process, securing approximately $800 million for their businesses, excluding the value of new vehicles.

We work hard to provide the expertise you expect from an industry leader. With each transaction, our principals bring unmatched experience to the table, including 153 transactions for 262 dealerships for value of more than $3.5 billion, excluding new vehicle inventories.

We help create the value our clients deserve for their lives’ work.

To each of our clients, thank you and congratulations.

Approximately $800,000,000 in dealership sales proceeds are reasons to celebrate.
Join us at AICPA in Las Vegas on October 6-7 at the Bellagio:

Alan Haig will address the current automotive buy-sell market.

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