THE HAIG REPORT®
TRENDS IN AUTO RETAIL AND THE IMPACT THEY HAVE ON DEALERSHIP VALUES
YEAR END 2015
The Buy-Sell Market Remains Hot, But Buyers Are Showing Signs Of Caution

Certainly, there has never been a better time in auto retail. Dealer profits are at all time highs and dealership valuations reached peak levels in 2015. From a buy-sell perspective, every reasonably priced dealership that comes to market is being snapped up by hungry buyers. The economic forecast is solid with low but steady growth, minimal inflation, cheap debt, and strong consumer confidence. And yet, some clouds are starting to form and we are seeing a split between the perspective of public and private dealers. Investors have marked down the value of the public retailers by about 24% from their peak in 2015 (after having fallen as much as 40% at the end of January). Public companies spent about half as much on acquisitions in 2015 as they did in 2014 and there is a strong chance they will spend even less in 2016. At their current valuations, most public companies are opting to buy back their shares or invest outside the US or in commercial vehicle businesses where prices are cheaper. On the other hand, most private dealer groups we speak with are bullish as they enjoyed an excellent 2015 and a strong start to 2016. They are still eager to acquire dealerships in 2016 that fit their strategies, while they also have their eye on the horizon when making offers so they do not overpay. And we may have just passed the peak in terms of average blue sky multiples, although we can see that average blue sky values per store may still increase if earnings continue to rise. New entrants to our industry are increasingly active. These entrants include Berkshire Hathaway, private equity firms, and family offices. In fact, these new entrants bought far more dealerships in 2015 than all of the public companies combined. In terms of the M&A market in 2016, we expect to see privately owned dealer groups and new entrants highly active in acquiring stores. The retrenchment of the public retailers is likely to provide a golden opportunity for private buyers to acquire prime dealerships that the public buyers would have aggressively pursued.

Buy-Sell Activity is A Mix of Ups and Downs

The total number of dealerships sold in 2015 increased 47% from 2014, making 2015 the most active year for buy-sells on record. Almost 90% of these dealerships were bought by buyers other than the traditional public retailers. Existing private dealers purchased 339 dealerships in 2015 compared to 264 dealerships in 2014, an increase of 28%. The Berkshire Hathaway acquisition of Van Tuyl Group was the biggest acquisition by far in terms of dealerships and deal value. So far in 2016, we continue to see significant levels of deal activity between private buyers and sellers, with no slow-down in sight.

While private buyers acquired hundreds of dealerships in 2015, the number of dealerships acquired by the publics decreased by 10% and the value of those acquisitions fell by about 50% to $773M. A big part of this decline was due to the spike in deal value in 2014 caused largely by the acquisition of DCH by Lithia. The total spent in 2015 came in at the bottom of the $750M-$1B range that we had predicted in our Q3 2015 report and we wonder when will they get back to this level of acquisition activity. Almost every CEO or CFO of the public retailers has stated that their stock prices have fallen to levels where their cash is better spent on stock buy-backs or acquisitions outside of the US. As such, we are expecting 2016 spending for the publics to come in lower than 2015, perhaps in the $500M range. (Note: the acquisition of the Van Tuyl Group by Berkshire Hathaway and any of its subsequent acquisitions are not included in these figures as Berkshire is so large that it does not report any data on its auto retail operations.)

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Blue Sky Multiples Remain High, But Some Luxury Brands Are Beginning to Contract

Private buyers continue to make strong offers for dealerships that fit their strategies. The drop in fuel prices has more dealers interested in buying franchises that are heavy on trucks and SUVs, such as the domestics. Key midline import franchises like Honda and Toyota are selling lots of vehicles and have a highly predictable business model. We see stable multiples for most mid-line franchises. However, all is not rosy in the buy-sell world as a number of buyers are expressing concerns with the shrinking margins at the German luxury brands. They complain that there is too much inventory and not enough growth to absorb it. Audi and BMW appear to be having the most problems at the moment, and private buyers are telling us they are slightly less motivated to acquire these brands until their margins can stabilize. Plus, dealers tell us they are dismayed by the cost of the facility requirements demanded from some of these OEMs. Given their comments to the press, we think public companies will have difficulty buying premium luxury dealerships until they see a significant recovery in their stock prices. This upcoming year is an opportunity for private buyers to purchase luxury stores that the public companies would have normally snapped up.

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) will pay for the goodwill of a franchise, in addition to the other assets. The blue sky multiple is 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. 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 will bring lower multiples. Underperforming dealerships can bring much higher multiples, and dealerships with facility issues may bring lower multiples. 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. The previous chart sets forth our estimates for the typical range of values that buyers will pay for the goodwill / blue sky of various franchises today.
Macroeconomic Indicators Are Mostly Positive

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

- **GDP Growth is Healthy.** 60 Economists surveyed by the Wall Street Journal’s Economic Forecasting Survey project GDP will grow 2.0% and 2.4% in Q1-2016 and Q2-2016, respectively. The Congressional Budget Office is predicting real GDP growth will be above 2.5% in 2016.
- **Interest Rates Remain Low.** The average cost for a five-year auto loan was 4.3% per Bankrate.com, down from 4.4% in December.
- **Employment and Household Income Are Increasing.** According to the WSJ the US added 242,000 jobs in February, pushing unemployment down to 4.9% overall, and 2.5% among college graduates. Household disposable income is up 3.5% on an annual rate, and housing values have risen 7% over the past year.
- **Number of Miles Driven Is Increasing.** The total number of miles driven, which drives the vehicle replacement rate and is a key measure of demand for autos, increased 3.5% in 2015 compared to 2014, according the US Federal Highway Administration.
- **Gas Prices Remain Low.** The energy Department reported that the average price per gallon of fuel was $1.78 as of 3/7/2016. Savings on gas will put about $1,000 into the pocket of the average household in 2016.
- **Increasing Household Wealth.** The Federal Reserve issued a report in March that showed the net worth of US households reached a record high level in Q4 2015. Much of the rise in net worth was due to the increasing value of real estate owned by households. The report stated that 61M households have at least 25% equity in their homes, whereas just 4.4M households have negative net worth.
- **Consumer Sentiment is High.** There is a strong correlation between auto sales and consumer sentiment. As the chart below shows, consumer sentiment has increased steadily since September and is almost at historically high levels.

There are, however, a few indicators that are giving some dealers concerns about the future:

- **Default Rates for Sub-Prime Loans Are Increasing.** According to Fitch Ratings, the 60 day delinquency rate for auto loans that have been packaged into bonds sold to investors over the past five years has increased to 5.16%, the highest level in almost two decades. Sub-prime lenders may have been too easy with their credit which has helped to boost auto sales. If delinquency rates begin to inflict pain on lenders, we would expect credit to contract and this could hurt future auto sales.
- **Profits at Some Dealers Are Declining.** For the past six years we have enjoyed rapidly rising sales that, for most dealers, have also led to a string of annual increases in profits. But some buyers tell us that stores they have been looking at in Q4 were showing declining profits, either due to sales slowdowns, lower margins, or higher costs.
- **Used Car Pricing Is Declining.** NADA posted data that showed that used vehicle wholesale prices fell 3.1% recently, the largest decline since November 2009. Lower used car prices may suppress new vehicle sales as it makes it more difficult for owners to trade in their vehicles for new ones, and used cars become more attractive as an option for buyers compared to new vehicles. Also, lower residual values on used cars will likely drive up the costs of auto leasing.
New Vehicle Sales At All Time High, But Growing More Slowly

New vehicle sales in 2015 reached 17.5M units, a record high but 2016 has started out even stronger as the SAAR in January and February was 5% and 7% better than 2015, respectively. There is debate among analysts about how much higher sales can go. Some experts believe 18 million is the new vehicle sales plateau in the US, but others see the industry going higher. John Murphy of Bank of America Merrill Lynch is perhaps the most bullish on the industry as he estimates new vehicle sales will grow to 20 million units in 2018 before cycling down to 14M in the mid-2020s. Here, we show a prediction for 2016 of 18.2M units, which would represent an increase of 4% over 2015, the lowest annual growth rate since the Great Recession ended.

Grosses Are Sliding: A Symptom of Oversupply?

Although retailers have much to be thankful for, perhaps the biggest challenge today is an erosion of gross profit on the sales of new and used vehicles. According to data published by the public retailers, profits per vehicle retailed declined 4.4% for new and 5.5% for used from 2014 to 2015. This trend is frustrating to many since the market is shifting towards luxury vehicles, trucks and SUVs that typically bring higher than average margins. Some of the decline has been happening in the midline import segment, in brands like Honda, Toyota, Nissan, Volkswagen, Kia and Hyundai. The decline has been driven by a number of factors, such as OEM stair step programs, turn and earn policies, TrueCar, the ease that consumers have in comparing prices on mobile devices, etc. Another factor is that the growth of luxury sales over recent years has largely been in the lower priced models that bring less margin. And one owner of mid-line franchises told us that he is seeing more negative equity in buyers, and that is hurting new vehicle margins as he has to sacrifice some profits in order to get the customers financed. But owners of premium luxury stores are complaining even louder about the decline in their new unit margins. The main culprit is an oversupply of new units, perhaps caused by slowing sales growth, but also the slowdown in China that OEMs are reacting to by sending more units to US dealers. While this slide is concerning, dealers tell us that the German OEMs are aware of the issue and working to correct the oversupply of vehicles. This may be an issue that can be fixed over the next six months, and so far, we don’t think there has been damage to the consumer’s perception of any of the German luxury brands, unlike the VW crisis that has driven off some of VW’s loyal customers.

Days Supply Has Increased Significantly for Some Brands, But Appears Healthy for Others

The following table shows the change in days supply from March 1, 2015 to March 1, 2016 for key categories. Note the spike in the days supply for the premium luxury brands, which increased an average of 26% from 49 days to 62 days during this period. One BMW dealer told us his days supply was over 100 when including the new units he had “RDR’ed” to satisfy BMW! Seeing this data, we understand why retailers are discounting their products to get them off their lots, thereby contributing to the decline in gross margins that the publics reported. Other brands, however, appear to have inventory levels in good shape. The domestic brands are
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Averaging 79 days, essentially flat to last year, and midline imports are averaging 57 days, a 9% improvement from last year. It is possible that the spike in days supply for March was an aberration, but when we also looked at the level of total inventories for these categories, we see that same story: a spike in the level of inventories for premium luxury brands.

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*Source: Automotive News*

Finance & Insurance Departments Are Generating Record Profits

The public retailers’ average F&I gross profit per vehicle retailed reached an all-time high of $1,379 per unit in 2015, up 5.7% from 2014. And since there is little expense against this revenue, much of the increase in the F&I department makes its way to the bottom line for the public retailers. These higher F&I profits are a nice offset from the decline in new and used margins.

Fixed Operations Are Driving Higher Profits

Almost six years of rising sales have been boosting the number of units in operation in the US and these vehicles are showing up in service drives around the country. Private dealers reported fixed operations increased 5.7% in 2015. Public retailers also did well, averaging 4.9% growth on a same-store basis in 2015 compared to 2014. Higher profits from fixed operations may continue to lift dealership profits even if vehicle sales and/or margins worsen.

Dealership Profits Continue Their Upward Trajectory.

The net outcome of the trends listed above is that profits at dealerships keep growing. Private dealerships generated an average of $1.167M in pre-tax profit over the last twelve months, up 7% over 2014.
The table below shows the annual change in profits over the past 16 years. We remain in a sweet period in auto retail that is showing steady growth in profits for dealers. This growth in profits has put smiles on the faces of almost every dealer we know, and is also attracting new buyers to our industry. However, many dealers tell us they are preparing for the time when sales stop growing and they will need to focus on operational improvements to maintain or increase their earnings.

And while private dealers are no doubt happy, public retailers are enjoying even stronger growth with earnings up 9.3% in 2015 over 2014. This growth includes acquisitions as well as same store results. Given these strong results, and the overall outlook for 2016, we believe investors in public companies may have overreacted and pushed stock prices down too far.

Sales Growth for Individual Franchises

The following table sets forth the change in new unit sales at the major franchises in 2015 compared to 2014. Six of the 11 brands that are beating the market are luxury brands, although for the first time in recent memory BMW and Mercedes-Benz underperformed the market. Domestic sales growth is pretty close to average, but we think their sales mix is shifting from fleet to retail which should mean more profits for dealers, and we expect their retail sales to grow faster than the market in 2016 if gas prices remain low and housing starts continue to grow.
BUY SELL TRENDS

Private Dealership Values Continue to Appreciate

We estimate that the average blue sky multiple for all franchises on an unweighted basis was 4.80x in Q4, up 1% from Q4 2014, and up 11% from Q4 2013. What may be more relevant, however, is we estimate the average blue sky multiple declined almost 1% from our Q3 2015 average multiple which was 4.84x. While this is a tiny change, and there is no way to know how accurate our estimates are, we may have just passed the “peak” in terms of blue sky multiples, but not necessarily blue sky values. The average profit per dealership according to NADA increased 7% in 2015 from 2014. Applying the 4.8x blue sky multiple to the average dealership pre-tax profit of $1.167M generates an average blue sky value of $5.60M, up 8% from 2014, 26% from 2013, and up 43% from 2012.

Even at these high valuations, dealership acquisitions provide attractive returns for buyers compared to other investment alternatives. The chart below shows a simple return-on-investment calculation for acquisitions of various types of franchises (valued with a blue sky multiple at low, average and high levels, plus working capital and assets equal to 1.0x pre-tax profit) compared to other investment options. We assume 50% financing for the leveraged figures.

Public Retailers Have Fallen in Value

While the value of privately owned dealerships has never been higher, we have seen a big sell off in the value of the public auto retailers. The average stock price for public retailers was approximately $54.58 per share on March 11, 2016, 24% below the highest level that they reached in the summer of 2015, and down 15% from the end of 2014.
There are a number of reasons for the decline in the valuation of the public companies. Mike Jackson from AutoNation made a number of strong statements in January about the weakness in sales and declining vehicle margins that put the stock prices of all of the public retailers into a major swoon, with values down an average of 40% by the end of January. The stocks have recovered somewhat since then, but some investors remain concerned that we may have reached a plateau in sales and that overproduction by the OEMs could erode the profits of dealers. The average price/earnings ratio for the publics has fallen from 18.4x at the end of 2014 to 12.4x on March 11, 2016, and now trades well below the 23.0x price/earnings ratio of the S&P 500, meaning that investors see less upside from auto retail than they do from the general economy.

Public Companies Have Shifted Their Focus Away From Acquiring US Auto Dealerships

The value of acquisitions completed by the publics in 2015 fell about 50% from 2014. Part of the decline was because of the $650M acquisition in 2014 of DCH by Lithia that was not replicated in 2015. But only two of the six public companies spent more than $100M in acquisitions in the US in 2015 compared to four of the six that spent over $100M in 2014. With an average price/earnings ratio of just 12.4x compared to their average price/earnings ratio of 15.2x from 2011-2015, most public companies have stated that they have decided to spend their capital on stock buy-backs, acquisitions outside of US auto retail, and improving the performance of the stores they already own. In 2016, the publics will close on a number of the deals that were in their pipeline from 2015, and they may close on a number of tuck-in acquisitions or larger transactions that perfectly match their strategies, but we believe they will likely be much less active than in prior years.

Private Dealer Groups Are Making Large Acquisitions

Private dealers continue to drive consolidation in our industry, and many dealers are generating huge amounts of cash that they want to put to work by buying more dealerships and dealership groups. The most common type of acquisition is a single store deal in an existing market. But we are also seeing private groups acquire large platforms in new markets. These private groups are capable of making acquisitions of hundreds of millions in transaction value, a realm that even public companies have rarely ventured into. They have access to large amounts of capital from lenders and their own savings, and they are less likely to have restrictions from OEM framework agreements that have long restricted the public companies from growing faster. An example of such a buyer is The Fields Group that announced it is acquiring Brumos Automotive (a Haig Partners client) in Jacksonville, FL, which owns two Mercedes-Benz dealerships, two Lexus dealerships and a Porsche dealership.

Private Equity and Family Offices Are Now Significant Players in Auto Retail

In 2015, we saw private equity firms and family offices acquire dozens of dealerships and we believe their appetite is much, much larger. One private equity firm told us they believe they will finish 2016 with over $2B in revenue from around 40 rooftops. While a few family offices have been in auto retail for some time, we saw an influx of new players in 2015. The Fremont Group (a Haig Partners client) closed on the acquisition of Morrie’s Automotive Group and Soros Fund Management has made an investment in McLarty Automotive that recently acquired a group of dealerships in Arkansas. These investors have backed experienced automotive retail executives and are building dealership groups that marry the entrepreneurial spirit of privately owned dealerships with the discipline of the public companies. Now that the publics have retrenched, private equity firms and family offices may have a greater opportunity to acquire prime dealerships and dealership groups, although we expect them to be disciplined in their offers to avoid overpaying.

Sales of Dealership Groups Are On The Rise

We have noticed an increase in the number of dealership groups that are coming to market, as opposed to individual stores. During 2015, The Banks Report lists 52 groups that sold or are in the process of being sold, with an average of 4.0 dealerships per group, compared to 48 groups with an average of 3.2 dealerships per group in 2014. There are a number of reasons for this. First, many dealers are advancing in years and are taking advantage of strong market conditions to sell their entire group. Second, buyers have lots of capital and are looking to grow quickly. And third, the growth in family offices and private equity firms is driving the demand for larger “platform deals” that bring them several hundred million dollars in revenue in a single transaction, as opposed to tuck-in deals that many of the major groups have been pursuing for years.
We have been involved in the purchase and sale of 225 dealerships in our careers dating back to 1996. Recently, we have had the pleasure of 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.

We continue to see strong pricing for German luxury brands, but buyers are currently frustrated a bit with Audi and BMW. Midline imports are highly predictable and remain in demand. We are seeing increasing demand for domestic stores due to their strength in the truck, CUV and SUV product segments that are growing faster than the overall market, and the relatively low prices for these franchises compared to luxury and midline import brands.

**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 of what a buyer participating in a competitive sales process (i.e. not the only buyer at the table) will pay for the goodwill of dealerships, and we note any upward or downward changes from the end of 2014. 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**

**Mercedes-Benz.** M-B remains much in demand as its dealerships are capable of generating high levels of profits and dealers are pleased with M-B’s leadership. Sales underperformed the market in 2015 for the first time in memory, up just 4% compared to the market average of 6%. We are currently involved in the sale of three MB stores and buyer interest remains keen. It’s possible that the demand for these stores will cool if margins remain compressed and/or sales flatten, but Mercedes-Benz remains “the adult in the room,” as one dealer said, compared to some other premium luxury brands, and is retaining its high level of desirability. Same multiple range: 7.5x-10.0x.

**BMW.** BMW has faltered a bit, with sales growing at just 2% compared to the average of 6%. This flattening of sales has corresponded with an increase in supply (perhaps some of the vehicles that were bound for China are now at US dealerships) that has caused new vehicle margins to fall. The days supply of new inventory soared 37% from 43 days supply on March 1, 2015 to 59 days supply on March 1, 2016. And the actual days supply could be much higher if vehicles that have been “RDR’ed” (meaning the dealer is showing the vehicles as sold even though they are unsold and still on the lot) are included. Further antagonizing dealers are the tough facility requirements that BMW is imposing; these will cost millions per location. After venting a bit, however, dealers will admit that they still want more of these franchises. They tell us that BMW is aware of the oversupply issue and working to address it, so perhaps margins will level off or even grow. Lower multiple range: 7.0x-9.0x.

**Audi.** While it has been perhaps the hottest franchise in recent years with sales growth far outpacing its German cousins, Audi is beginning to frustrate some members of its dealer base. Despite several years of rapid growth in volume, including an increase of 11% in 2015, these stores have yet to attain the same level of profits as BMW and M-B stores. However, Audi requires its dealers to make expensive investments in facilities and continues to put in add-points. And recently, the days supply of new vehicles has spiked 56%, rising from 52 days on 3/1/2015 to 81 days as of 3/1/2016, leading to margin compression. Audi dealers spent the last few years complaining they could not get enough units, but they are now awash in inventory, particularly sedans. Fortunately, we see no negative fallout from the VW emissions cheating scandal, and we believe Audi is smart enough to take actions to reduce oversupply that will help margins to recover. Until conditions get a little more friendly to dealers, however, we are reducing our range. Lower multiple range: 7.0x-9.0x.
Porsche. Porsche continues to perform strongly with sales up 10% in 2015. Per unit gross profits were remarkably high, but we are starting to see margins fall a bit. Dealers tell us this decline is partly due to an increase in the sale of Macans which are lower priced and therefore earn less margin. A decision by Porsche and its dealers to increase inventories to provide adequate supply of Macans and Cayennes, plus the unsellable diesel units have caused days supply to double from 45 days to 91 days over the past year, higher then almost any other brand! We hope margins do not compress further. Buyers should expect facility investments to handle the growth, plus some add points in southern markets. Dealers tell us they remain highly interested in Porsche stores, particularly in metro markets in which they can earn strong profits. Same multiple range: 7.5x-10.0x.

Lexus. With sales up an impressive 11% in 2015, Lexus had another excellent year and has almost taken the luxury sales crown back from BMW. Buyers tell us that Lexus “has its mojo back!” They are willing to put up with the high volume/low gross Toyota sales model because so much profit ends up dropping to the bottom line. Parts and service departments at Lexus stores have always been gold mines, and they should grow even further now that units in operation have increased so much over the past five years. Plus, unlike its German competitors, Lexus has not inflicted painful facility requirements on its dealers, so much of the cash flow from Lexus stores ends up in the pockets of their dealers. We expect more Lexus stores will sell in 2016 as they are performing at or near peak levels and Lexus has slightly relaxed its cap on multi-store ownership. Many of the original Lexus dealers may want to use this window of opportunity to exit. Same multiple range: 7.5x-9.0x.

Jaguar-Land Rover. JLR was up an amazing 26% (37% for Land Rover alone) in 2015 and sales are expected to increase even further 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 smaller JLR stores to cover overhead, and are also welcome at metro stores to help JLR stores better compete with other luxury brands that have a broader line up of cars and CUVs/SUVs. Not all is rosy, however. Margins have fallen on new Land Rovers as we understand JLR restructured its vehicle pricing and took one point of margin away from dealers. Also, days supply has doubled over the past year, rising from 26 days to 53 days. The plan now is for more volume and lower grosses which we hope 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 were up 3% in 2015 in a year in which it is transitioning to new products. Johann De Nysschen is working hard to make Cadillac into more of a luxury brand and is proposing some innovative ideas for smaller stores, but the problem remains that there are far too many Cadillac stores in the US so the average profit per store is much lower than premium luxury stores. Acura sales matched the market with an increase in 6%, but profits per store in some markets remain uninspiring to many buyers. Infiniti was up 14% in 2015, making it an increasingly interesting franchise. Competition is tough on these franchises with the German brands launching lower priced vehicles and the Koreans launching higher priced vehicles. 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. The new XC90 is a hit and volume is up 24% in 2015, 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 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. Same value range: $250,000 - $750,000.

## Mid-Line Import Franchise Blue Sky Multiples

**Toyota.** Toyota was up 4% 2015, less than the overall market. This surprised us since Toyota has plenty of trucks and CUVs, but we have to remember that its main strength over the years has been in Corollas and Camrys which are suffering in this low cost gas environment. Dealers have been complaining about declining new vehicle margins, but we are also hearing that Toyota’s new advertising covenants that are designed to raise grosses are having some positive effects. Despite the low margins, Toyota's high volume/low gross business model is proving to be highly profitable for most dealers. We are not aware of any expensive facility requirements that can sometimes impair goodwill in dealership sales. High profits per store and a right-sized dealer network 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 sales are now picking up thanks to a barrage of new or redesigned products like the Pilot, Civic, Ridgeline pickup, Odyssey, CR-V, Accord as well as the new HR-V that should help Honda to take share profitably in 2016. The 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 3 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. Continuing its torrid sales growth, Subaru sold 13% more units in 2015. 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. Subaru is increasing production capacity so growth can continue for some time, although the add points that are arriving in some markets will hurt neighboring dealers. Buyers may need to expand dealerships to handle the higher volume. Same multiple range: 4.0x-5.0x (with pricing higher in Snow-Belt states).

Kia. Sales beat the market, up 8% in 2015. We have been involved with several Kia franchises recently and we have been impressed with the nice margins and sales volumes that good dealers can generate. We hope Kia can help its dealers generate 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, just below the market average. 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. Hyundai also announced that it will launch Genesis Motors as a separate luxury franchise. This may consume significant engineering and marketing resources, and we hope its new strategy will not diminish its strength in producing the affordable vehicles for which it is known. Like Kia, 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.

Nissan. Sales were up 6% in 2015, off the rapid pace of growth in recent years but still at an average level for the industry. The factory continues to play a very active role in its dealer network, trying to create larger, better capitalized dealers in markets that will be able to outsell their facing Honda and Toyota dealers. We hear Nissan is encouraging weaker dealers to sell to preferred dealers, and is exercising its rights of first refusal in buy-sells to offer stores to preferred buyers. This will have a chilling effect on the value of Nissan stores. Preferred dealers don’t need to make strong offers to buy stores in their market: they can wait for another bidder to set the price and then step in at the last minute. And what non-preferred buyer wants to do the work to buy a Nissan store if the preferred buyer will have the last look? We feel that Nissan’s actions, while intended to give preferred Nissan dealers higher levels of profits, may be suppressing the natural value of Nissan stores. Given the strong sales growth in recent years, and some very nice profits we have seen at Nissan stores recently, we have been tempted to upgrade the franchise. But with so much influence from the factory, we don’t see buyers stretching to purchase these franchises. Plus, we wonder if it will be difficult for preferred dealers to sell a group of three or more Nissan stores in the same market when they want to retire. Will they get fair value for their stores, or will they suffer the fate of some Nissan dealers today who complain there are few buyers for their stores? Same multiple range: 3.0x-4.0x.

Mazda. Sales were up 4% in 2015, 2% below the industry average. Mazda has been underweighted in trucks and CUVs and that has cost them sales in this environment of cheap gas. On the other hand, we have been involved with the purchase or sale of four Mazda stores recently and all of them were nicely profitable. 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. We are increasingly concerned for this franchise. Sales are down 5% in a market that is up 6%, and much of this has to do with the emissions cheating scandal, as well as a product portfolio that is weighted to cars vs. CUVs/trucks. While we all felt the initial shock that VW deliberately misled regulators about its diesel emissions, feelings of fear and anger are beginning to filter into the dealer body. So far, despite the attention of VW’s highest management and best engineers, VW seems to have no idea how to fix the cars that are on the road, or the new diesel units that are unsalable and are deteriorating on VW lots around the US. VW’s last proposal to the California regulators and EPA was vehemently rejected and the termination this month of VW’s head of US operations is troubling. VW in the US seems truly adrift with no senior leadership, and no plan for how to regain the trust of dealers and customers. What if VW cannot reduce the emissions of these diesel powered cars? Will regulators allow these vehicles to continue to

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operate on US roads? If so, what will the cost be? Or might all these cars have to be repowered, and then sent back to dealers? And after that, how much would a customer pay for a 2015 ex-diesel Jetta or Passat in the middle (or end!) of 2016? All these questions are weighing heavily on the franchise value of VW stores. We are seeing leading dealers begin to give up on VW and attempt to sell their franchises. A dealer we know was offered a VW dealership for no blue sky and declined. One conundrum for buyers and sellers that will bedevil closings: what is the value of a new diesel VW that cannot be sold today and has no solution for the future? Plus, values for used VWs are down over 8% from last year compared to other brands which were essentially unchanged, making it harder for owners of used VWs to trade in their vehicles for new ones, and creating losses at VW’s leasing arm. Most recently we read about a class action lawsuit from US investors, and a possible lawsuit from VW dealers in the US. The environment is getting harder for this franchise. This could be a buying opportunity for dealers who have strong stomachs, but most will steer clear. Lower value range: $0 - $2,000,000.

MINI. Sales have jumped significantly in the first half of the year, but ended up just 4%, below the 6% increase the market enjoyed. Low gas prices are kryptonite to this franchise that now seems to be marketing how big its vehicles are, in contrast to earlier marketing messages about how small they were. Days supply jumped from an already high 77 days to 101 days over the past year. The MINI product is much more appealing than what we saw from Scion, smart and Fiat, but we wonder if small car franchises have a future in the US given low fuel prices. Since stand-alone MINI stores are marginally profitable, or even money losers, we value MINI stores as a range in dollars. As a friend to dealers, we wonder if BMW should consider a plan to let dealers put MINI back into the main BMW facilities to lower overhead and allow more profits to be generated. This business model worked quite well for dealers until BMW began to require dealers to separate the franchises. Lower value range: $500,000-$1,500,000.

**Domestic Franchise Blue Sky Multiples**

(Concat: 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, slightly below the market average, which surprises us since Ford is loaded with trucks, SUVs and CUVs so we would think they should be entering a golden era of sales and profitability. In fact, Ford is selling so many high-priced trucks that it could credibly say it the F-150 Series is the leading luxury franchise in the US. These high truck, CUV and SUV prices should mean higher profits for dealers, although falling margins on Ford cars do not help. And one dealer is concerned about Ford’s stair step program that he believes was hurting margins on all vehicles. We have been involved in the sales of three Ford dealerships recently. All were strongly profitable and got significant interest from buyers. Low gas prices should keep Ford dealerships in demand with many buyers. Same multiple range: 4.5x-5.5x.

**Chevrolet.** Sales were up 5% in 2015, equal to Ford, but slightly below the market, perhaps since GM is cutting its fleet sales to feed its retail channel. Light trucks, CUVs and SUVs comprise a large portion of Chevrolet sales and provide dealers with a nice stream of fixed operations down the road. We would expect Chevy to take retail share in this market without resorting to heavy incentives. GM stated in January that is was raising its profit estimates for 2016 above an excellent 2015, so GM should continue to develop attractive products and support its ability to provide low cost financing to dealers and customers. Low gas prices will keep Chevy stores in demand with buyers. Same multiple range: 3.5x-4.5x.

**FCA (Chrysler-Jeep-Dodge-Ram-Fiat).** FCA’s sales were up 8% in 2015, over the market average. Jeep is one of the fastest growing major brands in the industry with sales up 24%. A huge chunk of FCA’s sales are truck/SUV/CUV models so it remains very dependent on low gas prices. CEO Marchionne has said he thinks gas prices have “permanently” shifted lower, so he is doubling down on producing more Jeeps while planning to outsource production of low margin cars. This is an amazing, and gutsy, proposition! Some dealers have concerns with FCA. Its product quality remains mired in the basement, with 7 products ranking last or second to last in the 10 product segments in which it competes (Source: JD Power Initial Quality Study 2015). Plus, FCA seems to have given up on Fiat and is telling its dealers they can move Fiat out of stand-alone showrooms and into CJDR showrooms. Other than the upcoming Fiat Spyder, which is a rebadged Mazda Miata, we are not aware of any future products for Fiat dealers. This brand could be gone from the US in the next few years. Profits per CJDR dealership are likely to be at all-time high levels. 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%, more than the market, riding the boom in truck and SUV/CUV sales. GMC continues to perform particularly well with its full size trucks, SUVs and the new Canyon light truck. GM is thrilled with the GMC brand which it says is one of the most profitable in the world from the OEM perspective. Lower gas prices should drive more sales of trucks, Yukons and Denalis, plus Buick styling is beginning to find fans. Higher multiple range: 3.25x-4.25x.

SUMMARY

The buy-sell market for auto dealerships remains strong although we are beginning to see a divergence in the perspectives of public auto retailers and private dealers. Public dealers are spending most of their capital buying back stock or buying dealership assets abroad that are trading for lower multiples. Private dealers, on the other hand, continue to seek acquisitions of all sizes across the US. And while they want to grow, these buyers are increasingly aware of the economic cycle we are in and will be looking for transactions that are fairly priced. We have seen an increase in the supply of dealerships for sale, and this is beginning to shift the market from what has been a seller’s market to a more balanced environment in which fairly priced dealerships are finding numerous suitors, while “overpriced” dealerships are sitting and not selling. These private buyers include traditional dealership groups, but also well-capitalized private equity firms and family offices. There remains a tremendous amount of capital hunting for auto acquisitions. The average blue sky multiple for dealerships appears to be contracting slightly from the peak that we saw in the first part of 2015, although we believe multiples will remain elevated above historical levels because of low interest rates and because economic conditions in the US appear likely to maintain or increase dealership profits. We expect 2016 to be a highly active period in dealership buy-sells between private buyers and private sellers.

Haig Partners is seeing these conditions in our recent engagements. Most of our sale side engagements 2014 and 2015 involved public buyers, such as the sale of Valley Motors (Audi, Mercedes-Benz, Subaru and VW) to AutoNation, Mike Davidson Ford to Asbury, Mercedes-Benz of Reno to AutoNation and Freightliner of Chattanooga and Freightliner of Knoxville to Penske Automotive Group. But all of our most recent transactions are between private buyers and sellers. One of our clients, The Fremont Group, purchased Morrie’s Automotive, a group of 14 franchises in Minneapolis. We advised on the sale of two Kia stores in the Dallas market that both went to private buyers. Another client, Brumos Automotive, which consists of two Mercedes-Benz stores, two Lexus stores and a Porsche store in Jacksonville, FL has announced it is selling to the Fields Automotive Group, which owns a large number of luxury dealerships in FL and IL. And yet another client who owns a Mercedes-Benz dealership in the Southeast is under contract to sell to a private buyer. We are in market with several other dealerships groups and these are all under consideration for purchase by private dealer groups or a family office.

We know of no other firm that has a better understanding of the perspectives of both buyers and sellers of dealerships, 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 years is over $500M, excluding new vehicle inventory values, for an average value of over $45M per transaction. That said, we also are pleased to work on smaller transactions where we feel we can add value to the sale process.

About Haig Partners

Haig Partners provides expert advice and comprehensive services to auto dealers interested in selling their businesses or buying new ones. We have been involved in 150 transactions for 225 dealerships totaling more than $3.25 billion in value. With experience from Auto Nation and Asbury, as well as prominent investment banks, Haig Partners is the leading full-service firm in our industry. In the past two years, Haig Partners has helped its clients to sell their businesses for over $500 million, excluding the value of new vehicles.

Please visit our website at www.haigpartners.com for more information. We always enjoy hearing from dealers who are interested in buying or selling dealerships, or discussing the current state of the market.
To each of our clients, thank you and congratulations.

Over $500,000,000 in dealership sales proceeds are reasons to celebrate.

In the past two years, Haig Partners has guided some of America’s most successful dealers through the sale process, securing over $500 million for their businesses, excluding the value of new vehicles.

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