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BUSINESS VALUATION & FINANCIAL ADVISORY SERVICES

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VALUE FOCUS

Auto Dealer Industry

Issue No. 6 | Data as of Mid-Year 2020

Mercer Capital is a national business valuation and financial advisory firm. Valuations of auto dealers require special knowledge of the industry, hybrid valuation methods, and understanding of industry terminology. This newsletter provides useful statistical metrics of the auto industry as well as content about the unique industry factors and value drivers of business valuations. We can assist you and your clients in valuation and consulting matters within the auto industry.

We hope you find this newsletter to be a helpful resource and appreciate any feedback along the way. Please send suggested content topics or ideas that you'd like to see in future editions to Mercer Capital's Auto Dealer Industry Group Leader, Scott A. Womack, ASA, MAFF at **womacks@mercercapital.com**.

Take Advantage of Current Estate Planning Opportunities While You Can

It's nearly impossible to discuss anything automobile-related without mentioning the name Henry Ford. Henry Ford established the Ford Motor Company in 1903 and also became one of the founding fathers of the automated assembly line mode for the production of his Model T vehicle. One of the famous quotes attributed to Mr. Ford is that "failure is only the opportunity to begin again." This adage continues to inspire the auto industry today as it attempts to recover from turbulent economic conditions caused by the COVID-19 pandemic, much like its recovery from the Great Recession just a decade ago.

While economic recovery is still uncertain as the pandemic rages on and new relief bills are on promised but not yet realized, there currently exist potentially attractive estate planning opportunities for auto dealer owners.

Three converging factors have this fall shaping up to be the busiest estate planning season since 2012: 1) potentially depressed valuation of assets and businesses; 2) historically low interest rates; and, 3) political uncertainty going forward. Let's delve a little deeper into these three factors.

Potentially Depressed Valuations

At its core, the valuation of a business consists of three assumptions: cash flow, risk and growth. Cash flow can be defined as the expected earnings of a business into the future. With no certainty of the future, historical performance and recent performance can serve as a starting point for those future expectations. The second assumption is risk: *what are the risks*

Take Advantage of Current Estate Planning Opportunities While You Can

(continued)

that the company faces to achieve those expected cash flows? Risks can be internal such as labor and management or risks can be external such as the economy or competition. The final assumption to valuation is growth: *how are cash flows expected to grow in the future?*

All three of these valuation assumptions have been threatened by the pandemic. Recent cash flow has been threatened for most industries, not just the hospitality, retail, and restaurant industries. Certainly, for businesses, operating and economic risks have increased during the pandemic. As far as growth and recovery, we've all gotten an education into the alphabet soup of recovery: can the recovery for the general economy be described as v-shaped, u-shaped, w-shaped, k-shaped, or some other letter?

Historically Low Interest Rates

Those familiar with the concepts of finance and valuation also understand the relationship between interest rates and value. Generally, as interest rates (and risk) increase, the value of the asset decreases and vice versa. The pandemic and summer/fall of 2020 has created a unique opportunity regarding interest rates, as the Fed has brought rates to near zero in order to combat the pandemic.

How are interest rates used in estate planning? Attorneys utilize many structures when seeking to transfer family wealth from one generation to the next: Grantor Retained Annuity Trusts (GRATs), Charitable Remainder Unified Trusts (CRUTs), installment sales, interfamily loans, and many other structures. Most of these structures utilize some form of a note/loan between family members. Under current tax law, a family member could not make an interest-free loan to a child or grandchild without that portion of the loan being considered as a taxable gift. To shield that portion of the loan from being a taxable gift, the loan must carry a stated interest rate. The IRS establishes guidelines for these interest rates in the form of Applicable Federal Rates (AFRs), which are determined monthly by the U.S. Treasury. The mid-term AFR rates have been historically low, and below 1% for most of 2020.

How do low AFRs assist in estate planning? In addition to satisfying the IRS' requirement so that the interest portion of the loan will not be treated as a gift, the lower level of AFRs should motivate estate planning this fall. Often, the structures that attorneys use in this form of planning depend on the cash flow from the asset being transferred (perhaps an operational business as an example) to fund the debt service in connection with the loan. In times of lower AFRs, the debt service is

Take Advantage of Current Estate Planning Opportunities While You Can

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reduced, and it's easier for the cash flow from the asset to cover the debt service. Additionally, the success of these transfer vehicles is usually dependent on the potential growth and appreciation in value of that asset after it is transferred to the next generation. With historically low AFRs and greater expected rates of return on the transferred assets, there are potential arbitrage opportunities on the spread of those returns.

Uncertain Political Climate

The fall of 2020 brought the national election season, and along with it, political change. Two important tax provisions that affect estate planning are at stake: the estate tax credit and the step-up basis for tax treatment. The current estate tax credit is $11.6 million per individual, meaning a married couple can shield and pass an estate worth $23.2 million ($11.6 million times two) to their heirs without incurring estate taxes. This provision is set to sunset in 2026 and will return to an amount of $5 million-plus inflation adjustments, expected to settle at a figure between $6 – $7 million per individual. At those levels, the unified estate tax credit limit for couples would lower by approximately $9.2 million, resulting in a greater pool of family estates that would be subject to estate taxes. Given the victory of President-Elect Joe Biden, if the Senate flips after the Georgia run-off races, this provision could be debated and potentially changed sooner than 2026.

A second tax provision that aids in estate planning could also be in jeopardy this fall. Among the pillars of President-Elect Joe Biden's proposed tax plan is the elimination of the step-up basis for taxation. Under current U.S. tax laws, the assets of an estate pass to their heirs at a tax value established at death (or alternate date of valuation). The value is transferred to their heirs at this established value at death or a stepped-up basis. Biden's proposed tax plan would eliminate this step-up basis. Consider an estate portfolio with a value of $10 million and a tax basis of $2 million. Under the current unified estate tax credit, the portfolio example would not be subject to estate taxes and would transfer to the heirs at a stepped-up basis of $10 million. If the step-up basis was eliminated, the portfolio would transfer to the heirs at a basis of $2 million and would also be taxed on the imbedded capital gains of $8 million. If the Sentate flips with the election of two Democratic Senators in Georgia, the change in power in the White House could also lead to increases in the capital gains tax rates, which are currently set at 15-20%. Increased capital gains tax rates and the elimination of the step-up basis could greatly diminish the value of a family's portfolio at the death of the patriarch/matriarch.

Take Advantage of Current Estate Planning Opportunities While You Can

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Unique Estate Planning Opportunities in Auto Dealer Industry Today

As we previously discussed, there is a unique opportunity for owners in the auto dealership industry to capitalize on low interest rates for planning tools and potentially lower valuations of the underlying assets being transferred. **One of our previous blog posts** provided a market update on Blue Sky multiples. Despite market optimism, valuation and blue sky multiples of auto dealerships are still very specific to the individual dealership and consider their unique conditions including financial performance, competition, and local economic conditions among other factors.

In a previous ***Family Business Director* blog post**, colleague **Travis Harms** and I also discussed the impact of real estate on estate planning. It's very common for the operations of the dealership to be contained in one entity and the real estate where the dealership resides to be contained in a separate asset holding company. Often when owners of auto dealerships desire to transfer their wealth/assets to the next generation, they may have children that are active in the business and they may have children that are not active in the business. We have consulted with owners on a strategy to gift interests in the operating business to the active children and interests in the real estate holding company to the non-active children. Owners/parents often view this strategy as equitable to their children and seek to reward/incentivize the active children with a direct interest in the operations of the dealership.

Conclusion

Now is a unique time, rife with estate planning opportunities with potentially lower valuation of assets, historically low interest rates, and changing political winds. Seek qualified professionals to assist you with your estate planning, from the attorneys determining and drafting the plan to the valuation professional providing the valuation. Not all valuations and valuation professionals are created equally. The role of all of the professionals in your estate planning process should be to protect the integrity of the proposed transaction. Often when these transactions are challenged, they are challenged based on the formation factors or the quality/conclusion of the valuation. Contact a professional at Mercer Capital to assist you and your attorney with your valuation needs involving your estate planning. Mercer Capital has extensive experience providing valuations for estate planning and valuations specific to the auto dealership industry.

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Q3 2020 Earnings Calls

Low Supply and SG&A Reductions Lead to Record Earnings

Third quarter earnings calls started with an optimistic tone, with just about every call reporting record earnings despite revenue headwinds. Advertising and personnel costs that were taken out at the beginning of the pandemic haven't come back as dealers try to determine how best they can run lean and improve productivity. Tight inventories continue to plague new vehicle volumes, which isn't expected to get better until the turn of the year. To compensate for this volume decline, dealers have strategically priced the models they did have in stock. Executives noted some points in the quarter where certain models were completely out of stock. Trucks and crossovers have been particularly hot, representing over 75% of vehicles sold.

Speaking of crossovers, many executives discussed the point of the transaction where consumers cross over from digital to in-person. During significant shelter-in-place restrictions that caused April lows, dealers were thrust into their online strategies and there were many prognostications about the potential long-term impacts. As the pandemic has persisted, consumers appear to have indicated a preference to beginning the process online, but the desire to test drive the vehicle or discuss the financing has limited the amount of fully online transactions.

While Carvana is the new kid on the block in terms of public auto retailing, it's their used-online operations that franchised dealers are looking to mirror. Across many calls, Carvana's name was invoked as the key comparative tool to

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measure how digital offerings match up. While executives all project confidence about their used platforms, it appears clear that the well capitalized online used retailer has an advantage in this area. Still, franchised dealers have their own advantages with access to new vehicles and fixed operations.

With consumers still spending a significant amount of time in their homes, the collision business has seen an impact as miles driven has decreased. While miles driven would appear to be the most direct indication of demand for autos, interestingly, executives have noted another trend. With the decrease in rental business and ridesharing, it looks like auto retailing may be regaining market share, which would benefit the industry if this trend continues as the number of miles driven rebounds.

The recent Hummer EV unveiling also drew the attention of analysts and executives. The consensus was the hype surrounding the relaunch of a brand that was defunct since the financial crisis was a positive sign for GM, and the shift to electrification will continue. However, many noted the importance of quality models in this shift as consumers won't be willing to pay up for vehicles (or expensive batteries) that don't stand up on their own just because they're electric. This is particularly true with low prevailing fuel costs. While the Hummer EV's price point allows for good margins, it means volumes will be much lower and ultimately will have less of an impact on dealership profitability.

Theme 1: Dealers made significant investments in digital offerings to compete under strict stay-at-home orders. As the pandemic persists, executives believe digital will continue to play a role particularly at the beginning of the shopping experience, though it is unlikely car buying moves fully online.

» [I]n this day and age 95% of the people are looking online first. – David Hult, CEO, Asbury Automotive Group

» [I]f a consumer wants to, which is less than 2% of the population right now[,] they can go online, buy a car from end-to-end, no touchpoints […] I think about 15% to 16%, 17% of our customer base right now is completing some percentage of the transaction online before they come to the store to pick it up. […] The consumers are telling us that they want to be able to search our inventory online, but they want to come to a store, sit with an

Q3 2020 Earnings Calls

(continued)

associate that's got experience dealing with the car that they're looking at. They want to test drive from a big inventory before they buy a car and make that decision. Our goal in our hybrid approach from A to Z is to allow them, if they want to go A to J or they want to go A to Z, our system is going to allow that to happen. – Jeff Dyke, President, Sonic Automotive

» About 80% of our consumers use digital forms in some way during the process. We actually only sell about 1.5% of our cars today on a truly digital end-to-end type of solution. – Bryan DeBoer, President, and CEO, Lithia Motors

Theme 2: Demand continues to outstrip supply as manufacturers struggle to get new vehicles to dealers. Consensus appears to be 2021 before this begins to normalize. Tight inventories have led to higher gross margins.

» We've had of course running conversations with the manufacturers since the spring, and every target has been missed. What we've been told we would be shipped, it simply did not happen. I don't see any change in the fourth quarter from what I understand is coming through, and so now we're into the first quarter, best case. When I see that they're able to consistently achieve their shipping targets, then we can talk about what you can sell new. The demand is there at retail. I'm not worried about the demand. […] we'll either get it through the volume or we'll get it through pricing. – Mike Jackson, Chairman & CEO, AutoNation

» Availability is coming back. I think we've got or 1,000 or 1,200 more cars on the ground at this point than we did last month at this time. And that just keeps improving every month. Manufacturing is doing a great job getting inventory back in our hands. The demand is there, and I think we'll all be back and rolling as we move into the first and second quarter of next year as supplies build. From a used car perspective, […] the supply is endless. – Jeff Dyke, President, Sonic Automotive

» The substantial improvements in gross profit of over $1,000 per unit compared to third quarter of 2019 are largely attributed to high level of incentives from our OEM partners and a perceived inventory shortage in the country. –Bryan DeBoer, Presiden, and CEO, Lithia Motors

Q3 2020 Earnings Calls

(continued)

- Operators are very savvy, when they cannot replace a vehicle. They don't sell it as cheaply. I mean, that's the simple thing. They know whether they can trade with another dealer, and if they can replace it. So that's driving these high margins throughout the industry. And the ramp up in supply from the OEMs has been far below what anyone in our sector would have expected. We're just now starting to receive a few more vehicles and we're retailing every month. But our new vehicle inventory year-over-year, one point drop something like 12,000 units. So we were still nowhere near back to normal levels. And I'm sure, we're not the only one. So while the reduction in margins going forward will be proportionate to the increase in inventory, there still appears to be a long way to go before the industry is back to normal move vehicle and inventory levels. – Earl Hesterberg, President and CEO, Group 1 Automotive
- As we sit here today that we're still benefitting in our GPUs from the lower inventory and we anticipate at this point to benefit throughout the quarter. The virus is starting to heat, but backed up as we all know, assuming factories don't shut down at all, we anticipated some point in the first quarter to get inventory levels somewhat back to normal, and at that point you would assume you would feel it into margins, but we don't see that happening in Q4. – David Hult, CEO, Asbury Automotive Group

Theme 3: While working from home has led to a decline in miles driven which has negatively impacted collision, other areas of parts and service have come back. Despite fewer miles driven, some executives also believe there is a structural change in demand wherein consumers want their own vehicles.

- In our products and service numbers that we disclosed collisions in there. Collision for us is running, for 12% to 15%, back, depending upon the market. So that's pulling back our CP numbers. We've been positive for the last few months in service specifically, as it relates to customer pay in warranty. – David Hult, CEO, Asbury Automotive Group
- I think we got to think a little bit socially what's really happening, with a vehicle market and personal mobility. […] Personal mobility […] should create some more demand and use cars and also new cars now, not high luxury cars. But I mean, cars that we would use on a daily basis if you needed transportation, because I

Q3 2020 Earnings Calls

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think combined transportation where two or three people are together, whether it's in a transit, public transit, whether it's a rental car, whether it's Uber or Lyft, I think there's some softness in those businesses, which will drive more automotive sales for us both in new and used. So I think these are things that personal use, will be help us drive a bigger part of the share of the auto business in the future. And I could be wrong. But there's definitely a flight to safety. – Roger Penske, Chairman & CEO, Penske Automotive Group

» There has been a significant shift towards individual mobility as a result of the pandemic and shelter-in-place. This has increased demand across the board from pre-owned through new in every segment. This individual retail demand is lasting and will continue for the next several years. – Mike Jackson, Chairman & CEO, AutoNation

Conclusion

At Mercer Capital, we follow the auto industry closely in order to stay current with trends in the marketplace. These give insight into the market that may exist for a private dealership. To understand how the above themes may or may not impact your business, contact a professional at Mercer Capital to discuss your needs in confidence.

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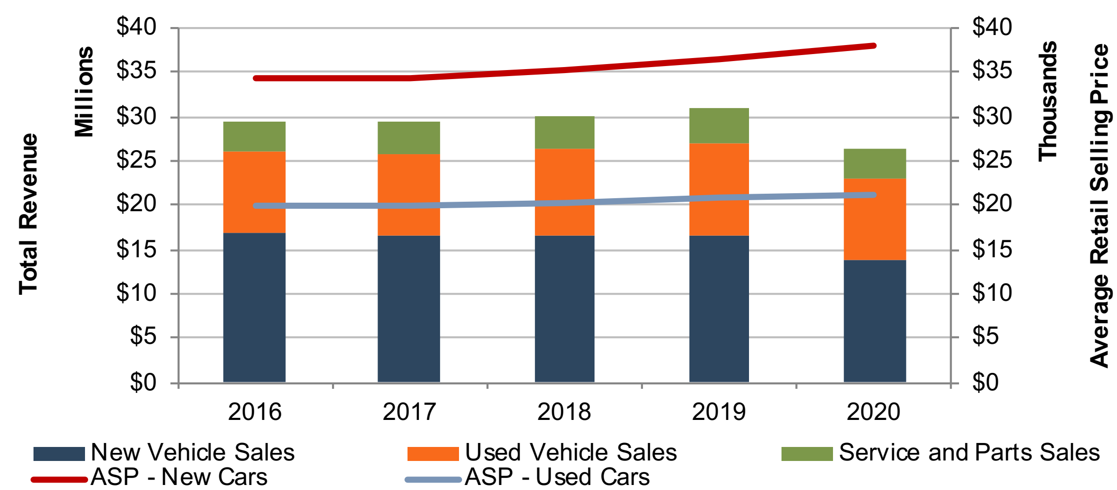
Average Annual Auto Dealer Profile

As of Mid-Year 2020

Average total sales per dealership decreased 15.1% through mid-year 2020 (compared to mid-year 2019), driven by declines across the board. Sales for new vehicles and service and parts each declined about 17% while used vehicle sales declined only 11.5%. The economic fallout from the COVID-19 pandemic and stay-at-home orders have been a driving force behind these declines. New vehicle revenue continues to make up more than half of dealership revenues at 52.8% through June 2020, down from 54% last year. After successive years of increases, the sharp decline in sales so far in 2020 has caused revenue to decline at a compound annual rate for all the departments, with used vehicles, service and parts, and new vehicles, down 0.5%, 1.4%, and 4.6%, respectively since 2016. Total sales have declined at a compound annual rate of 2.8% in this period.

In the first half of 2020, the average retail selling price of new cars and trucks increased 4.5% though the number of new vehicles sold decreased 20.4%. Used vehicle sales also increased in price (1.8%) and declined in quantity (11.3%) for this period. Near zero interest rates have contributed to these boosts in price, as have inventory constraints from manufacturing slowdowns. The gap in average selling price (ASP) between new and used cars increased as new cars retail for an average of over $38 thousand while used cars on average sell for just over $21.2 thousand.

Total Sales and ASP for Average Light Vehicle Dealers



Source: NADA

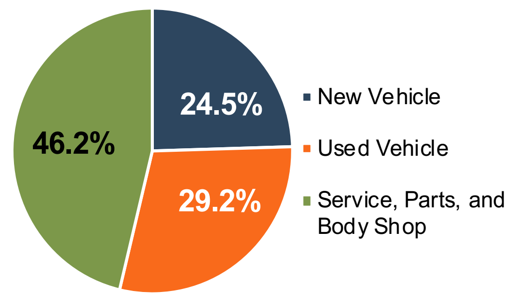
Domestic Dealerships

As of Mid-Year 2020

Gross Profit Trends

Gross profit declined 7.9% through the first half of 2020 for domestic dealerships; gross profit of $2.9 million was the lowest it has been in the past five years after trending upwards since 2016. Domestic dealerships continue to earn the lowest gross profit compared to import, luxury, and mass market dealerships. Nearly half of gross profit in the first half of 2020 came from service and parts departments for domestic dealerships. While the remainder appears relatively evenly split between used and new vehicles, the 29.2% contribution to total gross was the highest through June in the last five years.

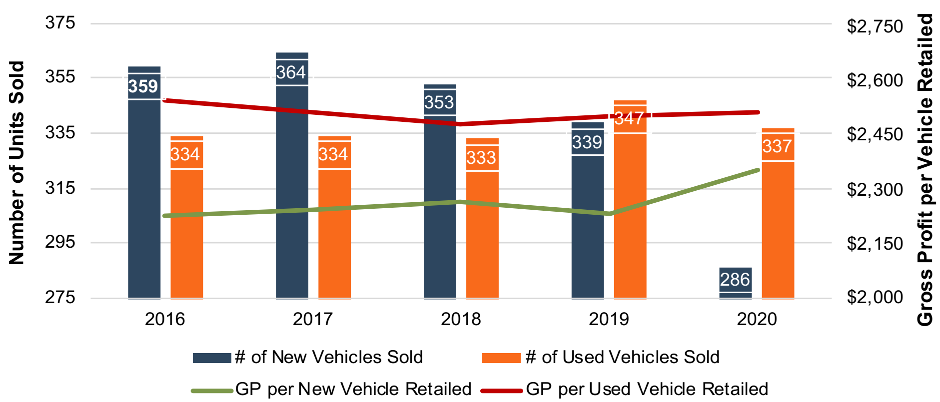
Gross Profit by Segment



Source: NADA

The number of new cars sold dropped 15.6% in the first half of 2020, notably below the peak in 2017. Gross profit per new vehicle sold increased 5.5% in 2020 to a recent high of $2,357 per vehicle retailed, reflecting increased new vehicle prices and these lower volumes. While gross profit per used vehicle has generally declined since 2016, the first half of 2020 showed an uptick to $2,517, which continues to be higher than new vehicle gross per vehicle retailed. While this is partially due to declining volumes, the 2.9% decline in used volumes was far less than the 15.6% decline for new vehicle volumes. Average retail selling prices increased 5.7% and 1.5% for new and used vehicles, respectively, but relatively steady margins for new (5.6%) and used (11.8%) vehicles indicates dealers have largely passed on increased costs to consumers.

New and Used Vehicles Sold and Gross Profit per Unit



Source: NADA

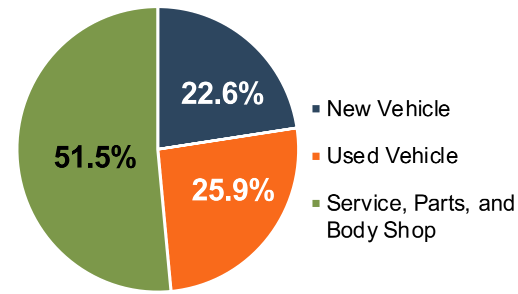
Import Dealerships

As of Mid-Year 2020

Gross Profit Trends

Gross profit dropped 19.7% through the first half of 2020 for import dealerships, led by declines in new vehicle and service and parts departments. This was the lowest level of gross profit ($3.3 million) in the past five years. More than half of gross profit in the first half of 2020 came from service and parts departments for import dealerships. Service and parts departments have considerably higher margins, which allows them to make up a significant portion of gross profit without being a large portion of dealership revenues. However, service and parts contribution has declined in 2020 to the lowest levels since 2017, which is most likely a factor of the pandemic as drivers spent less time on the road and thus, less wear-and-tear than needs to be addressed. The decline in service and parts contribution was picked up by used car contributions of 25.9%, which was the largest over the five-year period.

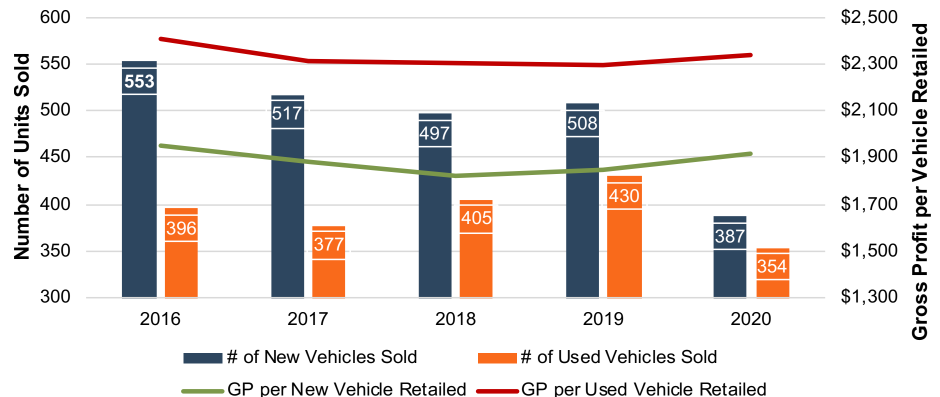
Gross Profit by Segment



Source: NADA

New and used vehicle sales volumes for import dealerships declined in the first half of 2020 compared to 2019. Both new and used auto hit their lowest points in the past five years, down 23.8% and 17.7% respectively from this time last year. Though sales were down, gross profit per retailed vehicle (both new and used) increased in a similar fashion to domestic dealerships, with lower volumes sold but increased vehicle prices. Gross profit per for new vehicles are up 3.8% and up 1.9% for used. However, this rebound was not enough to offset the declines in gross profit per vehicle that occurred from 2016 to 2018 as the compound annual growth rates for new and used are both negative at 0.4% and 0.7%, respectively.

New and Used Vehicles Sold and Gross Profit per Unit



Source: NADA

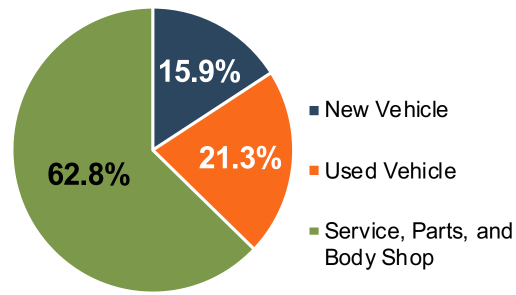
Luxury Dealerships

As of Mid-Year 2020

Gross Profit Trends

Gross profit declined 19.4% to just above $4 million through the first half of 2020 for luxury dealerships, reaching its lowest level in the past five years. Gross profit margin for new vehicles is currently 3.8%, the lowest level over the five-year period and lowest level for all types of dealerships. Used gross margins of 8.4% are also the lowest for any type of dealership through June, though margins are slightly better than this time in 2019. Overall, cost of sales per car are greater for luxury than in domestic, import, or mass market. Luxury dealerships receive the highest percentage of their gross profit from service and parts departments as consumers are more likely to return to a dealership for servicing when they purchase a more expensive vehicle. Through June, service and parts contribution to gross profit of 62.8% is the highest over the five-year period, steadily increasing from 57.6% of luxury gross profit through June 2016. However, service and parts revenues have actually declined nearly 25% from a recent high of $6.9 million in 2016 to $5.2 million in 2020 (including a 17.3% decline in 2020 alone).

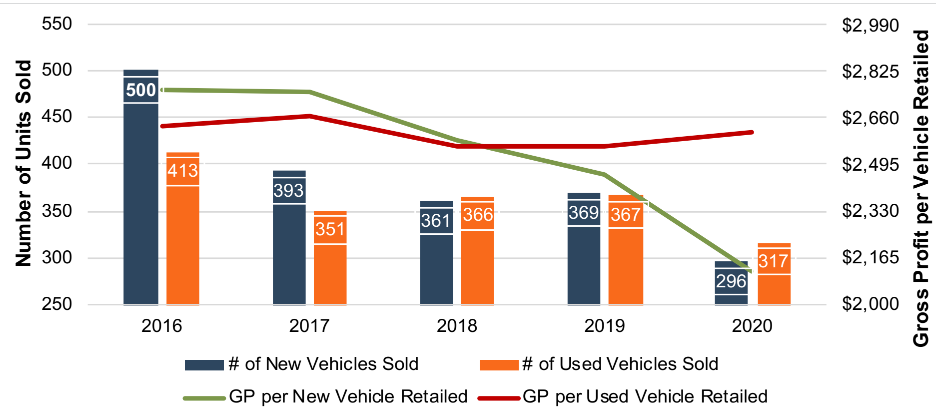
Gross Profit by Segment



Source: NADA

The number of new cars and trucks sold dropped over dropped to its lowest levels over the five-year period, down 41% from its peak in 2016. Likewise, used vehicle sales have also dropped to its lowest level, down 14% from its highest level in 2019. Despite these declines, gross profit per new vehicle has also declined substantially at 13.8% for 2020 and a compound annual rate of -6.4%. Historically, luxury has had the highest gross profit per new vehicle due to higher prices, but gross profit per new luxury vehicle ($2,122) now trails gross profit per new domestic vehicle ($2,357). In contrast, gross profit per used luxury vehicle has seen a bit of an uptick, increasing by 1.9% in the first half of 2020 compared to 2019. Though still not back to recent peaks in 2017, this continues to be higher than the gross profit earned at any other type of dealership.

New and Used Vehicles Sold and Gross Profit per Unit



Source: NADA

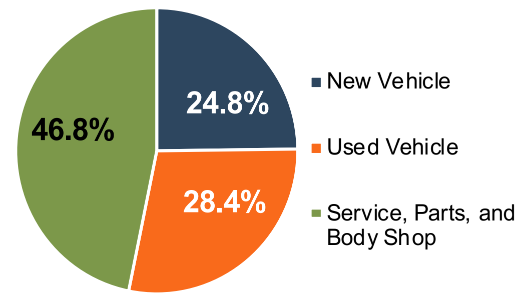
Mass Market Dealerships

As of Mid-Year 2020

Gross Profit Trends

Gross profit declined 14.2% through the first half of 2020 for mass market dealerships, reaching the lowest point in the past five years at just below $3 million. Like most other types of dealerships, approximately half of gross profit in the first half of 2019 came from service and parts departments, with the remainder made up of used vehicles followed by new vehicles. Used vehicle gross profit contributions of 28.4% are the highest over the five-year period. New and used vehicle volumes declined by 20.4% and 11%, respectively, while service and parts sales has declined as well.

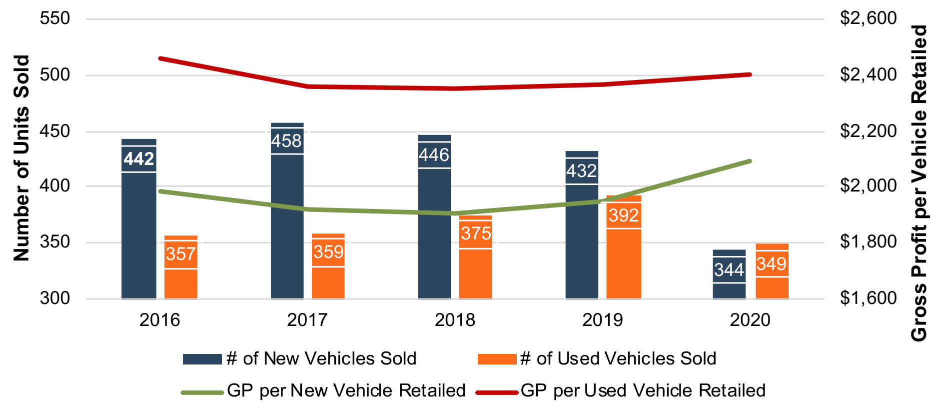
Gross Profit by Segment



Source: NADA

Like other types of dealers, used vehicle sales for mass market dealerships have had less of a decline than new as consumers increasingly choose used vehicles. New vehicle volumes hit their lowest point over the five-year period and are down 25% from their peak in 2017. For the first time through June since at least 2016, the average mass market dealership sold more used vehicles than new, reflecting consumer preference shifts during the recession toward lower cost vehicles. However, the decline in new vehicle volumes has raised gross profit per new vehicle increasing by 7.3% in 2020, as volume declined more than gross profit amidst price increases. Despite outpacing new, used vehicle volumes were also at a low, down 11% from last year which was a recent peak. This decline in volume has positively impacted gross profit per used vehicle, though notably less so than for new. Gross profit per used vehicle is up 1.4% from the prior year.

New and Used Vehicles Sold and Gross Profit per Unit



Source: NADA

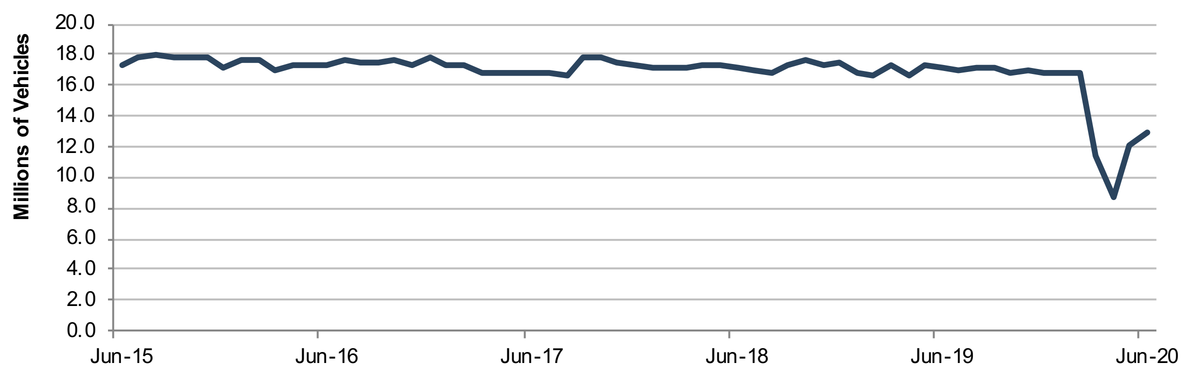
Light Weight Vehicle Sales: Autos And Light Trucks (SAAR)

As of Mid-Year 2020

A Seasonally Adjusted Annual Rate (SAAR) is defined as a rate adjustment used for economic or business data, such as sales or employment figures that attempts to remove seasonal variations in the data. In the automotive space, it is understood to mean the number of light weight vehicles sales (autos and light trucks) sold in a given month, adjusted for seasonal factors and scaled up to a year's worth of sales based on that month.

SAAR, an often quoted figure for auto dealers, stood at 13.0 million in June 2020. This was below the 17.2 observed in June 2019, and volume for the first six months of 2019 was down 23.6% compared to the first half of 2019. Though SAAR has improved from 8.7 million in April of this year, it remains 24% below the volumes threshold of 17 million reached in each of the past five years which has been a positive sign for the industry. Production slowdowns have hurt vehicle inventory and SAAR, with inventory entering June at a nine-year low for the period. The Fed has indicated that interest rates are anticipated to remain near zero for the next three years, which will help decrease vehicle costs for consumers going forward.

Light Weight Vehicle Sales: Autos and Light Trucks, Seasonally Adjusted Annual Rate



Source: St. Louis Fed

Light Weight Vehicle Sales: Autos And Light Trucks (SAAR)

As of Mid-Year 2020

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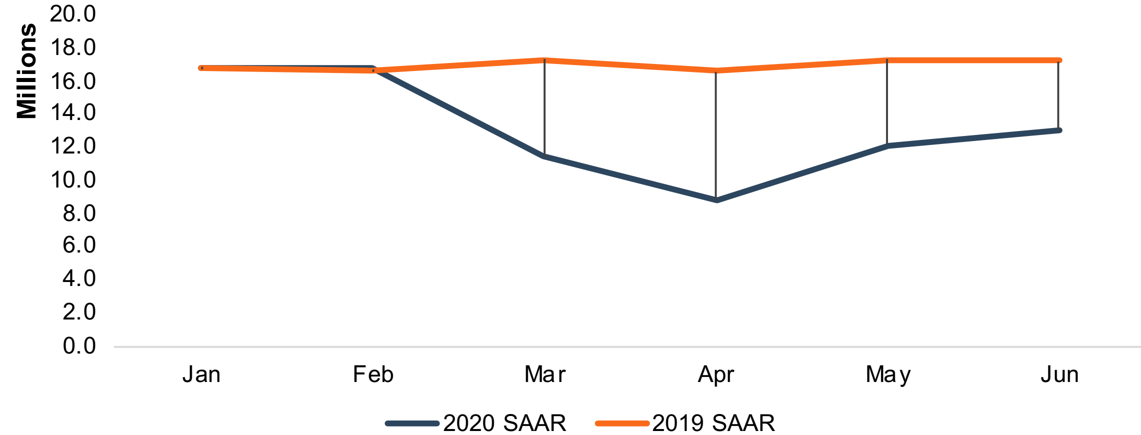
Because of the acute decline in SAAR as of March from the pandemic, observing growth rates from month-to-month is somewhat misleading. Though SAAR growth rates have slowed in the past few months, SAAR is returning to higher portions of pre-COVID levels, increasing from a low of 53% in April to a high of 76% in June. Through September, SAAR has continued to rebound, up to 16.3 million or 96% of September 2019. However, this number is somewhat inflated as the Saturday of Labor Day in 2019 fell in August instead of September.

Comparative SAAR



Source: FRED

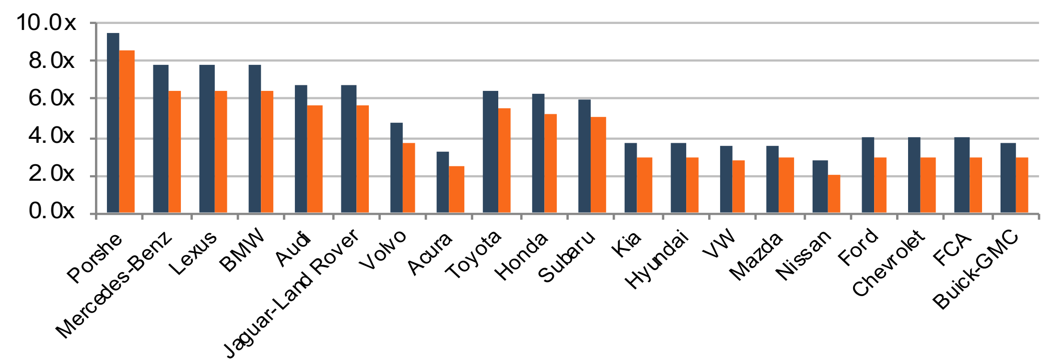
Blue Sky Multiples

As of Mid-Year 2020

Blue sky multiples come from the Haig Report and are calculated as a multiple of adjusted pre-tax profits. The ranges are an expression of what buyers in a competitive situation will pay for the goodwill of dealerships. Dealerships that are underperforming or in desirable markets will have high multiples while those that are over-performing, are in less desirable markets, or have significant real-estate issues will have lower multiples. In some cases, only a franchise value range is reported, indicating underperforming brands that potentially have negative earnings for which a pre-tax multiple would be non-meaningful.

In Q1, virtually every brand covered in the Haig Report saw a decline in their Blue Sky multiple. Fortunately, as SAAR rebounded, heightened levels of uncertainty abated, dealers and the country at large embraced and adapted to the new normal, and valuations rebounded in Q2.

New and Used Vehicles Sold and Gross Profit per Unit



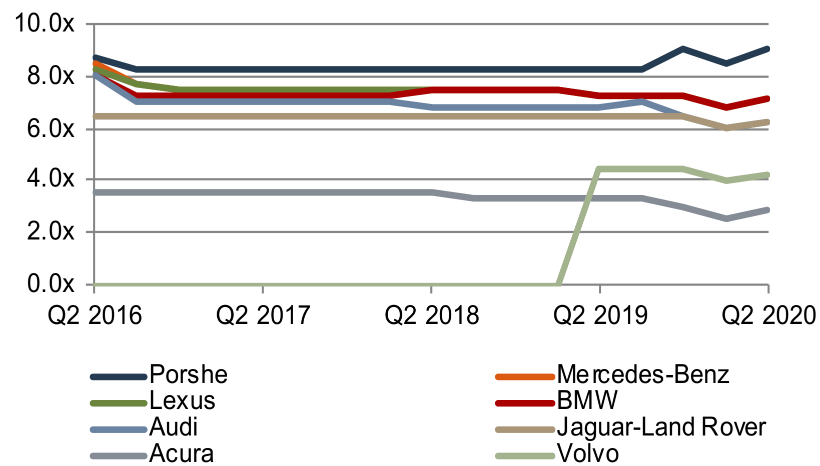
Source: Haig Report

Blue Sky Multiples History

As of Mid-Year 2020

Luxury Blue Sky History

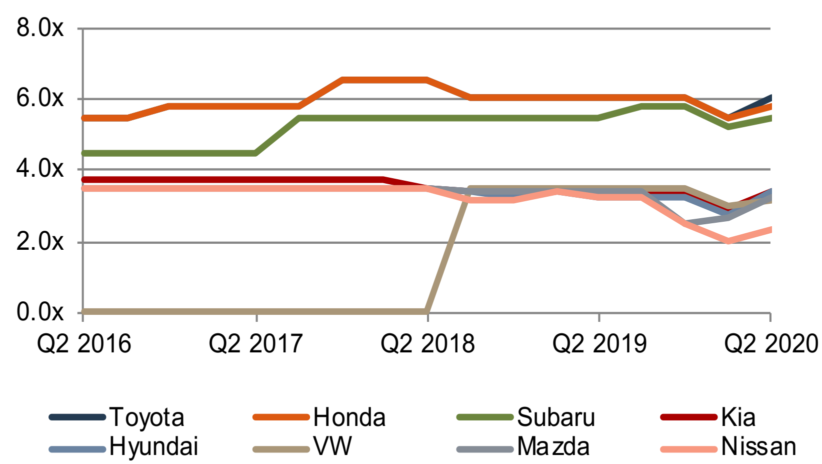
Luxury Blue Sky multiples for the first half of 2020 followed the overall trend described above with drops in Q1 and partial rebound in Q2. However, no luxury brands besides Porsche saw a full rebound to the top end of the pre-pandemic range. Haig Partners has continued its trend of reporting brands individually by reporting separate figures for Acura and Infiniti. Historically they have had the same multiple, but for Q2, Infiniti has joined Cadillac as brands without multiples. Lincoln has also moved into this group. Notably, all dealerships saw sales declines in the first half of 2020.



Source: Haig Report

Mid-Line Import Blue Sky History

Mid-Line imports multiples for Q2 generally saw more resiliency than the other groups. Mazda's multiples actually improved over Q4 2019. This likely has less to do with pandemic mitigation as it does with other recent troubles. While Mazda's franchise sales fell the least (7% decline) of all the major franchises compared to 1H 2019, this may say more about 2019 performance than it does about pandemic mitigation. Its range of Blue Sky multiples has improved in each of the last two quarters, but Mazda still remains slightly below its range of 3.0x - 3.75x from Q3 2019. Hyundai saw a modest uptick as well on the high end to pull even with Kia at 3.0x - 3.75x compared to 3.0x - 3.50x in Q4 2019. Toyota and Kia rebounded fully to their Q4 2019 multiple range.



Source: Haig Report

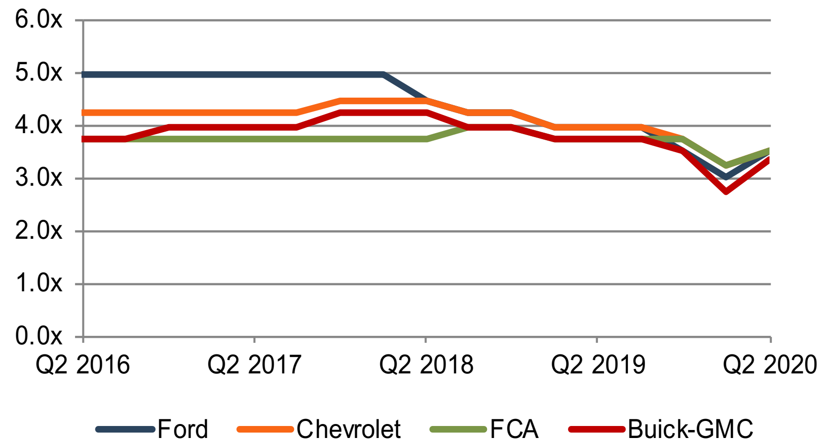
Blue Sky Multiples History

As of Mid-Year 2020

(continued)

Domestic Blue Sky History

Domestic franchises generally followed the overall trend of declines in Q1 and partial rebounds in Q2. FCA's high multiple of 4x trails pre-COVID multiple highs of 4.25x. Buick-GMC and Chevrolet are also down a quarter turn of pre-tax profits (0.25x) from pre-COVID levels. Ford is a notable exception to this as its multiples have returned to pre-pandemic values at 3.0x-4.0x, as there is optimism surrounding the new CEO Jim Farley and the return of the Bronco.



Source: Haig Report

Auto Dealer Industry

Mercer Capital has expertise providing business valuation and financial advisory services to companies in the auto dealer industry.

Mercer Capital provides business valuation and financial advisory services to auto dealerships throughout the nation. We provide valuation services for tax purposes, buy-sell agreements, partner buyouts, and other corporate planning purposes. Mercer Capital also works with owners who are considering the sale of their dealership or the acquisition.

Services Provided

- Valuation of auto dealer industry companies
- Transaction advisory for mergers, acquisitions and divestitures
- Valuations for purchase accounting and impairment testing
- Fairness and solvency opinions
- Litigation support for economic damages and valuation and shareholder disputes

Contact a Mercer Capital professional to discuss your needs in confidence.

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