

With the launch of its first quarterly report, The Presidio Group aims to share the firm’s dealership valuation expertise and insights on the latest trends in mergers and acquisitions. The Presidio team’s viewpoint and data analysis are informed, in part, by our work with many of the country’s biggest, and most influential, dealership groups. These relationships give us an insider’s view of how experienced and sophisticated operators value deals in the real world. Our analysis includes:

[Overall Market Update](#) | [Dealership Valuation Overview](#) | [Presidio Valuation Index](#)

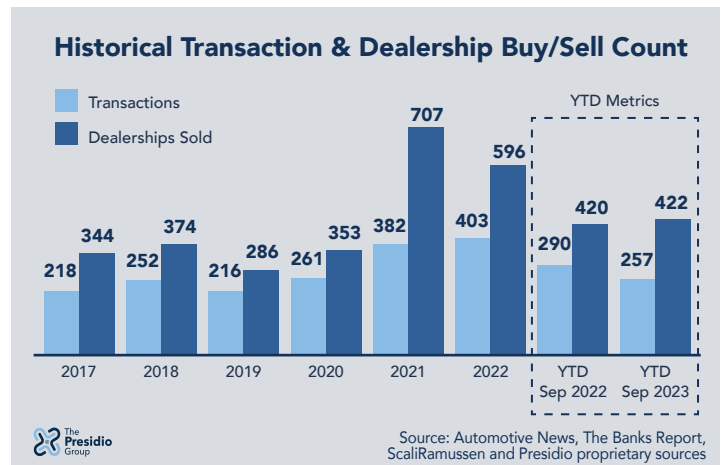
Overall Market Update

Dealership transaction volume, as tracked through the first nine months of 2023, declined approximately 11 percent compared with the same period in 2022, which produced an industry record number of 403 transactions per Automotive News reporting for the full year. Presidio estimates at least 257 transactions involving 422 dealerships occurred through September 2023. Even with the decline in deal activity so far this year, transaction volume is still well above pre-pandemic levels.

As of June 2023, there were 18,280 franchised dealerships in the U.S., according to Urban Science. Private dealers owned 94 percent of stores, while public consolidators held 6 percent. According to the National Automobile Dealers Association, 92 percent of U.S. dealers owned one to five franchised stores as of mid-2023.

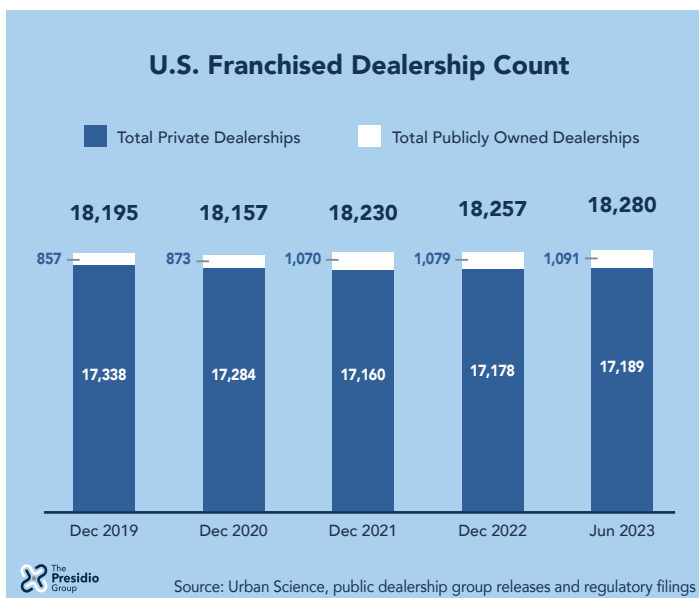
This year, private dealers continue to lead the way on acquisitions, accounting for 96 percent of all transactions reported by Automotive News through the third quarter.

For the first nine months of 2023, public groups collectively



“A few years ago, we were the smallest by far of the publics, and we’ve been trying to grow in markets where we think it will stabilize and strengthen our company. And we think we’ve effectively done that.”

— Asbury Automotive CEO David Hult on Asbury’s third-quarter earnings call



spent more than \$2 billion on acquisitions, including buying 30 stores in the U.S. Quietly, the public groups have also divested 22 stores this year. Some of these large consolidators also are expanding overseas. Lithia Motors in March acquired Jardine Motors, with more than 40 franchise points in the United Kingdom, and this fall struck a deal to buy Pendragon and its 160 U.K. outlets. Certain public groups have set bold acquisition growth targets, and Lithia and Asbury Automotive Group are both well over halfway to their expansion goals. Presidio expects the public retailers collectively will continue to buy high-caliber dealerships that further their strategic growth. And they have the financial muscle to do so; the average total liquidity of the six public groups has nearly doubled since the end of 2019.

The industry’s four-year wave of robust earnings, which resulted in record dealership valuations, appears to have finally crested and is heading back down. Inventories and margins have begun to normalize, and cost increases across the board are creeping back into the market. With 2023 shaping up to be perhaps the third-most profitable year on record, earnings are still well above pre-pandemic levels, but it seems clear that dealership income and other financial measurements are moderating. It all adds up to what Presidio has dubbed the “Great Normalization.” The industry still faces significant headwinds, including sustained high levels of inflation, higher interest rates and global political risks. And the effects of the industry’s long-term supply chain disruption linger.

The changes are accompanied by a more balanced yet still strong M&A market. It’s no longer purely a sellers’ market, but plenty of buyers remain in the hunt to acquire the limited number of dealerships that come available each year.

“We’re in a buy mode. We want to grow the company. We want to continue to expand our footprint. We like to grow and fill out in clusters where we are.”

— Group 1 Automotive CEO Daryl Kenningham on Presidio’s Full Throttle podcast in April 2023

Dealership demand remains strong across all states and geographies, but higher premiums continue to be paid for stores in pro-business states such as Texas, Tennessee and Florida vs. more heavily regulated states such as California, New York and Illinois.

Dealership Valuation Overview

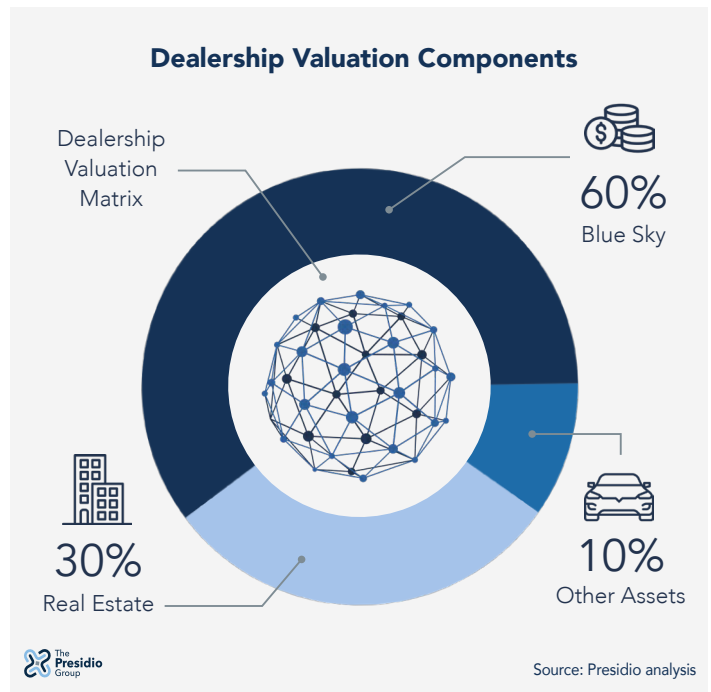
The Presidio team believes every dealership is unique and that the industrywide standard of applying a blue-sky multiple to earnings to determine value is far too simplistic and inadequate. Properly valuing these unique businesses requires an in-depth analysis of the specific factors and characteristics of each dealership. We detail that later in Presidio’s Valuation Matrix.

Getting to the right valuation also means considering the total investment, not just blue sky. Falling into the trap of solely focusing on blue sky ignores nearly 40 percent of the overall investment equation. Blue sky typically accounts for about 60 percent of total investment in the average dealership, while real estate and other assets make up the remaining 40 percent. The symbiotic relationship among these components correlates to a dealership’s total cash flow and, ultimately, return on investment.

So what about blue sky?

In its simplest form, total blue-sky value is calculated using earnings before interest, taxes, depreciation and amortization — essentially, pre-tax earnings — times a multiple. For too long, a majority of dealership buyers and sellers have placed too much emphasis on blue-sky multiples and not enough on the appropriate level of sustainable, long-term earnings or other investment components required to operate dealerships.

The most common question asked of Presidio team members is: “What is my blue-sky multiple?” Presidio focuses very little on multiples, which have remained in a tight band since consolidation activity first escalated more than 20 years ago. At Presidio, we focus most of our attention and expertise toward evaluating earnings, the unique components of each dealership supporting its earnings and the remaining components of the investment equation.



Focusing solely on blue-sky multiples is problematic for several reasons, including:

1. Blue-sky value is driven primarily by earnings, with a focus on pro forma historical earnings, sustainability of future earnings and prospects for earnings growth. Many factors contribute to the unique value of each dealership, with earnings having a greater bearing on ultimate value than blue-sky multiples.
2. Blue sky ignores a significant portion of the total equation — on average 40 percent as referenced earlier. That results in unreliable and incomparable return-on-investment assumptions. Earnings used by many in the industry contain a rent or equivalent expense related to property values that is incorrectly applied.
3. Returns calculated solely on blue sky are not accurate. Buyers and sellers should consider return on investment based on expected future cash flows — in other words, the level of sustainable earnings. What matters is the total investment required, which includes the value of real estate and excludes associated carrying costs, not just blue sky.

LESS FOCUS ON BLUE SKY → MORE FOCUS ON ROI

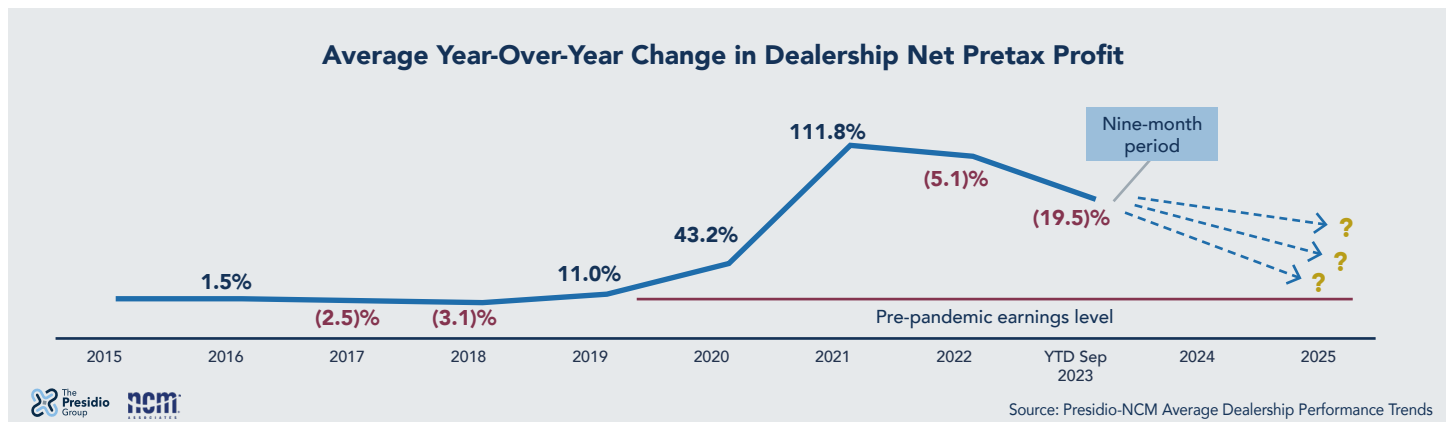
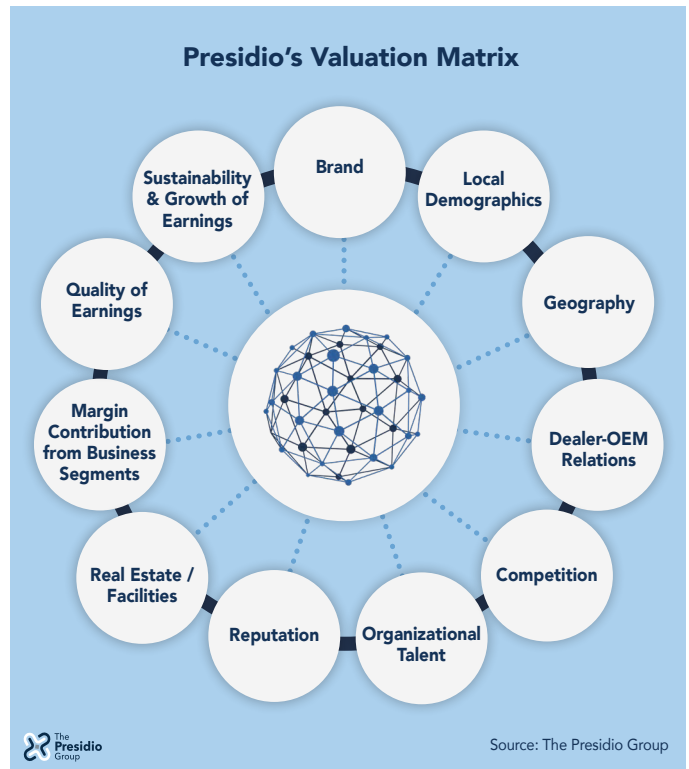
Focus on Sustainable Earnings

No two dealerships have the same individual characteristics, earnings potential and, ultimately, predictable and sustainable cash flows. Numerous factors come into play in determining cash-flow potential and sustainability, including brand, geography, competition, facilities and dealership reputation. The many factors are laid out in Presidio’s Valuation Matrix (right).

Historically, dealerships on average generated profit equaling about 3 percent of revenues. That varied, however, with dealerships representing luxury brands coming in above that average and outperforming their import- and domestic-brand peers. But from 2020 to 2022, those percentages doubled or even tripled — ranging from 6 percent to more than 10 percent in some cases. Such outsized profits were never sustainable, and a more normalized margin, inventory and cost environment is now upon us.

So where will dealership earnings ultimately end up?

The chart below depicts earnings growth for the average dealership during the last nine years, according to the Presidio-NCM Average Dealership Performance Trends report. The pandemic profit bubble is clearly seen in 2021 and 2022.



As earnings normalize, some brands may fully revert to prior levels, while others are more likely to remain elevated compared with pre-pandemic earnings, albeit not at the records seen in 2021 and 2022. Not all brands are created equal, and Presidio estimates the normalization process for earnings as a percentage of revenues will vary across segments generally as follows:

Luxury brands: 5-7% | Top-tier import brands: 4-6% | Domestic/Other value brands: 2-4%

The Presidio Valuation Index

Historically, brand multiples have commonly been applied to trailing 12-month earnings streams or three-year average earnings streams to calculate blue-sky values.

Given the unpredictability of normalized profit levels, the Presidio team believes earnings as a percentage of dealership revenue is an alternative — and less volatile — concept to apply. After all, using earnings on a trailing 12-month level or across a three-year average captures the peak of the COVID bubble, and 2019 seems a lifetime ago.

Presidio also maintains that ROI is too often calculated incorrectly or not considered.

The Presidio Valuation Index is intended to help stakeholders triangulate an estimated value of a dealership using numerous data points and formulas that consider sustainable earnings, the unique micro and macro characteristics of each dealership and the total investment required (not just blue sky). Here are the approach's three central pillars:

Blue-Sky Earnings Multiples | Revenue Multiplier (%) | Return on Investment (ROI)

Blue-Sky Earnings Multiples

Blue-sky multiple ranges should be cautiously applied once comfort is attained regarding sustainable earnings levels as covered earlier in this section. The various characteristics laid out in Presidio's Valuation Matrix on the previous page, including brand, growth trajectory and real estate, must be weighed when applying these multiples.

Revenue Multiplier

Presidio's revenue multiplier ranges can be applied to normalized revenue streams (so excluding large fleet sales or one-time revenue items) to estimate blue-sky value ranges. The Presidio team believes this proprietary approach using revenue as a value indicator can help buyers and sellers triangulate blue-sky value ranges while mitigating volatility in times of uncertainty. As proven by the last three years, earnings can be erratic, making a calculation based on historical profit level less reliable. But a store's revenue is generally more consistent, making a calculation based on both that and brand a more appropriate predictor of worth.

For example: \$100 million in revenue x 40 percent (the Toyota revenue multiplier) = \$40 million in blue sky























Return on Investment

In any investment or M&A decision, return on investment ultimately is all that matters. Since blue sky only accounts for approximately 60 percent of total investment required, an ROI calculation that factors in real estate and other assets required to operate a dealership, while considering appropriate risk levels, is more inclusive and accurate. ROI percentages are the inverse of blue-sky multiples — the higher the ROI, the lower the multiple and vice-versa. In other words, more risk yields more reward. To calculate ROI, one must first understand: a) a dealership's total cash flow (sustainable earnings with rent or related expenses added back) and b) total dealership investment.

The Presidio Valuation Index

Valuing any business is complex. There is no cookie-cutter approach, and many factors must be considered. But the Presidio Valuation Index can help. It applies the three pillars of valuation and uses other key factors such as a brand's network size and average throughput (the number of new vehicles sold per outlet).

Our guide is still simply a guide though. Anyone looking to sell or buy dealerships should consider turning to experts to conduct a much deeper evaluation to determine value. The experts at Presidio, who have decades of experience and have completed 270-plus transactions valued at more than \$18 billion, are ready to assist.

Presidio Valuation Pillars →	Blue Sky as % of Revenue Range	Blue-Sky Multiple Range	Average Estimated ROI	Number of Dealerships	Number of New Vehicles Sold/Dealership
 Lexus	50% - 60%	9.0 - 10.0	<10%	244	1,060
 Porsche	50% - 60%	9.0 - 10.0	↑	197	357
 BMW	45% - 55%	7.8 - 9.0		350	947
 Toyota	40% - 45%	7.5 - 9.0		1,238	1,494
 Mercedes-Benz	45% - 55%	7.5 - 9.0		383	916
 Land Rover	33% - 42%	6.5 - 8.0		200	284
 Audi	33% - 40%	6.5 - 7.5		304	615
 Subaru	30% - 35%	6.0 - 7.0		638	875
 Honda	26% - 35%	5.8 - 7.0		1,068	826
 Kia	18% - 23%	4.8 - 5.8		781	892
 Hyundai	15% - 20%	4.0 - 5.0		15%	835
 Chevrolet	15% - 20%	4.0 - 5.0	↓	2,904	517
 Ford	14% - 19%	3.8 - 4.5		2,967	593
 Cadillac	13% - 18%	3.5 - 4.5		564	240
 Volvo	13% - 18%	3.5 - 4.5		282	361
 Mazda	13% - 18%	3.3 - 4.3		543	543
 VW	10% - 15%	3.0 - 4.0		640	472
 CDJR	10% - 15%	3.0 - 4.0		2,410 ¹	638
 Buick-GMC	10% - 15%	3.0 - 4.0		1,672 ²	310
 Nissan	10% - 15%	3.0 - 4.0		1,079	633
 Acura	10% - 15%	3.0 - 4.0		271	378
 Infiniti	9% - 13%	2.5 - 3.5	20%	204	230

1) Dealership count represents Chrysler outlets

2) Dealership count represents GMC outlets

Source: Presidio proprietary data/analysis, Automotive News Dealer Census