

THE  
BLUE SKY REPORT®  
A KERRIGAN QUARTERLY



Second Quarter 2018

August 2018

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KERRIGAN ADVISORS



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Securities offered through Bridge Capital Associates, Inc., Member FINRA, SIPC

# Professional. Personal. Discreet.

The leading sell-side advisor to auto dealers nationwide.

## RECENTLY ANNOUNCED TRANSACTIONS

Kerrigan Advisors represented



Top Volume Toyota & Subaru Dealerships  
in the Northwest

in their sale to

AutoGroup

June 1, 2018

Kerrigan Advisors represented



Highest Volume KIA Dealership in the U.S.

in its sale to



Trophy Automotive  
Dealer Group

August 21, 2018

*"Erin Kerrigan did an excellent job of finding us the perfect buyer and keeping me calm and focused through an emotionally difficult and life altering experience. Her tireless work to match appropriate buyer and seller is something every seller contemplating the sale of such an important asset should take advantage of."*

**Dave Jachter**

Prior Owner of Wilsonville Toyota & Subaru

*"I'd like to thank Kerrigan Advisors for smoothly guiding us through this process, with such a high level of professionalism – they truly understand everything a seller goes through and offered sensitivity, a keen understanding of the current (and future) automotive landscape and support every step of the way."*

**Matthew Phillips**

CEO of Car Pros Automotive Group

Since 2015, Kerrigan Advisors has sold 72 dealerships, including five of the Top 100 Dealership Groups, more than any other firm in the industry. Kerrigan Advisors' customized sales process is discreet, effective and proven. If you would like to learn more about our firm, contact Erin Kerrigan or Ryan Kerrigan at **(949) 202-2200** or visit [KerriganAdvisors.com](http://KerriganAdvisors.com).

# KERRIGAN ADVISORS

## DEALERSHIP ACQUISITION ACTIVITY

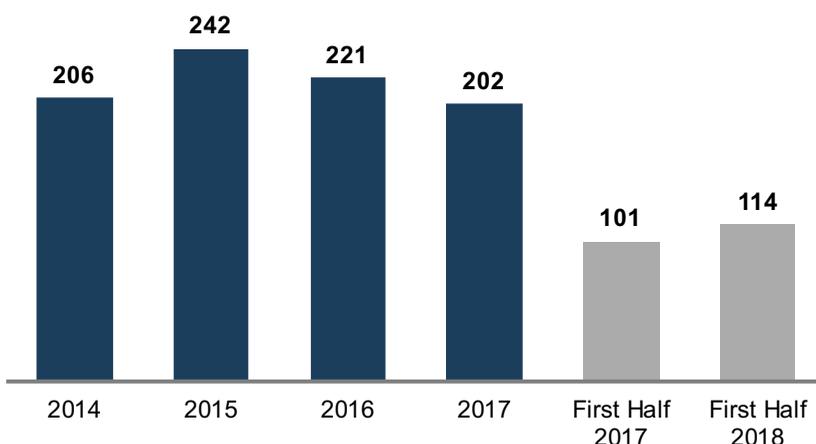
After a slow start to the year, the buy/sell market picked up steam in the second quarter. 75 transactions were completed during the quarter, as compared to 39 in the first quarter, an impressive 92% increase. Based on this buy/sell activity, 2018 is tracking to be another 200+ transaction year – the fifth consecutive year of over 200 industry transactions. Since 2014, Kerrigan Advisors estimates 1/8<sup>th</sup> of the dealer body has changed hands as industry consolidation continues at a rapid pace.

**Chart I**  
**Number of Auto Retail Transactions Completed**  
**2014 – First Half 2018**

Source: *The Banks Report and Kerrigan Advisors' Analysis*

Note: A transaction represents a single buyer and a single seller; however, one transaction can represent multiple franchises and dealerships.

The buy/sell activity in the second quarter of 2018 rebounded to a very high level after a slow first quarter. Kerrigan Advisors expects 2018 to be the 5<sup>th</sup> consecutive year of over 200 buy/sells.



*"We are very excited about all of the M&A activity out there."*

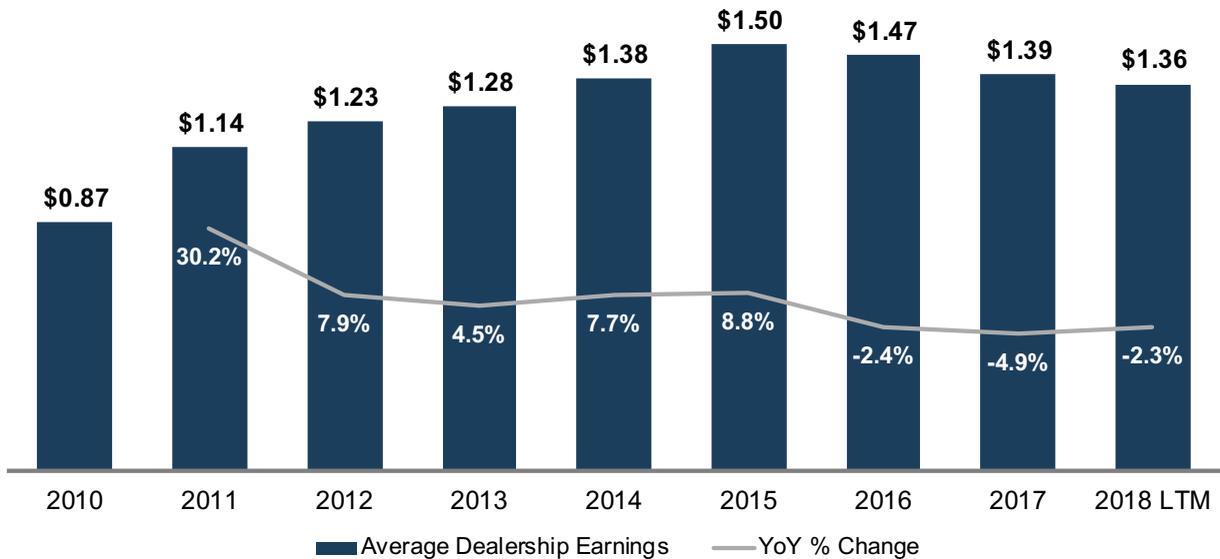
**David Hult, President & CEO**  
**Asbury Automotive Group**  
**Second Quarter 2018 Earnings Call**

Blue sky values remained high in the quarter, though below 2017's levels. Lower blue sky values were driven by declines in dealership profits (see Chart II on the following page) rather than a decline in blue sky multiples. Dealership profits were impacted by rising interest rates, most evident in floorplan cost increases (see Chart III on the following page). In fact, the decline in average dealership earnings in the first half of 2018 (\$32,371) approximated the rise in average floorplan expense during the period (\$35,403).

**Chart II**  
**Average Dealership Earnings and Year-Over-Year Change in Earnings (\$ in Millions)**  
**2010 – 2018 LTM**

Source: NADA and Kerrigan Advisors' Analysis

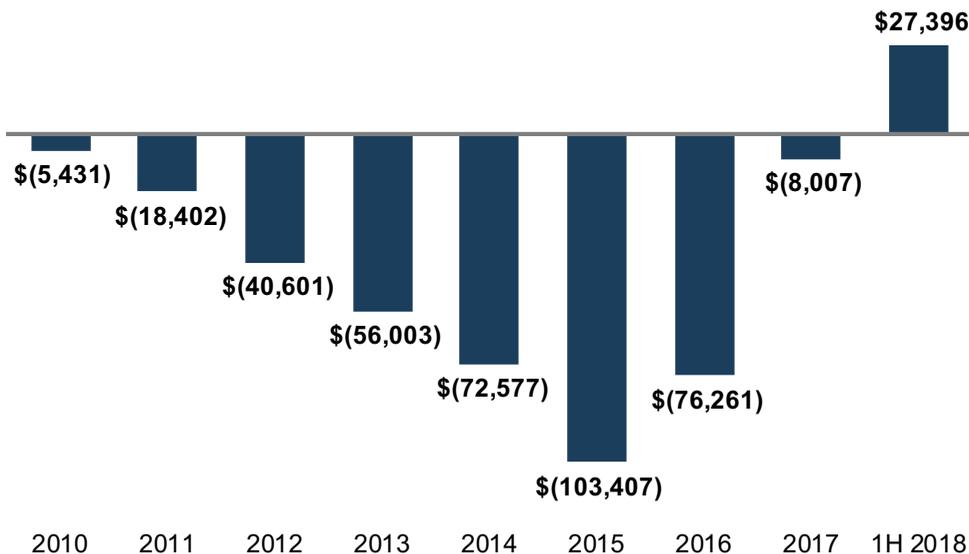
Average dealership earnings are down 9% from their 2015 peak. On a historic basis, average dealership earnings remain very high and above pre-recession levels.



**Chart III**  
**Average Dealership Floorplan Interest Expense**  
**2010 – First Half 2018**

Source: NADA and Kerrigan Advisors' Analysis

The decline in dealership earnings during the first half of 2018 approximated the increase in floorplan expense. As interest rates continue to rise, dealers are focusing on inventory management solutions to reduce floorplan expense.

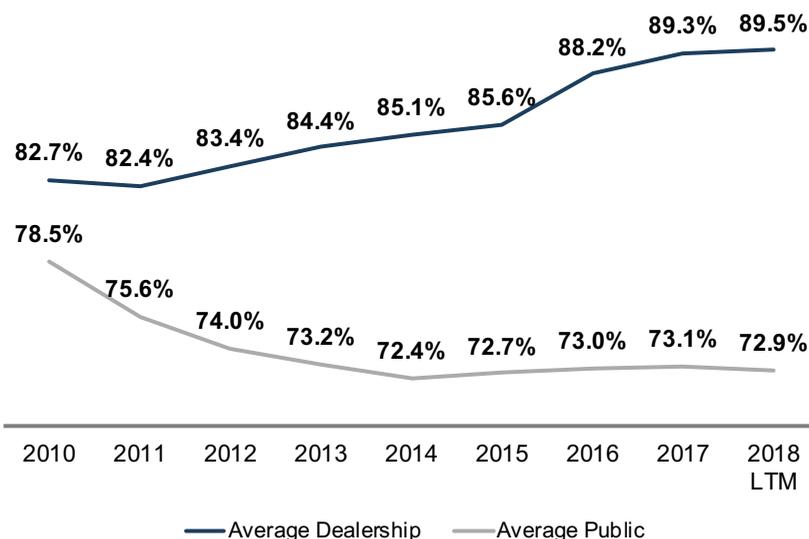


The good news is that most dealers remained highly profitable during the quarter. Large consolidators saw their earnings grow, bucking industry trends. Most of the publics, for instance, reported record earnings in the second quarter, attributing much of their success to improved economies of scale and scope, as well as reduced taxes due to the recent tax reform.

A clear example of the largest group's ability to increase profits through economies of scale is the public's ability to reduce SG&A (sales, general and administrative) expense relative to gross profit since 2010. The extreme contrast between the SG&A costs of the largest dealership groups versus the average dealership (see Chart IV below) is a testament to the increasing importance of scale in auto retail.

**Chart IV**  
**SG&A Expense as % of Gross Profit (Average Dealership vs. Average Public)**  
**2010 – 2018 LTM**

Source: NADA, SEC Filings, and Kerrigan Advisors Analysis



The largest dealership groups are successfully reducing their operating expenses through economies of scale. By contrast, smaller dealership groups struggle to economize their operations, resulting in higher SG&A expenses relative to gross profits.

As economies of scale and scope become a key driver of future profits, the industry's bifurcation between the consolidators and the to-be-consolidated is playing out in the earnings trajectories of these two groups. The consolidators are finding new ways to grow earnings by employing technology, streamlining their business models, changing their selling systems and introducing new products across their platforms, while the to-be-consolidated are maxing out on their ability to squeeze more profit out of their existing business model, because they are limited by size and balance sheet.

In this environment, the consolidators see significant opportunity to increase earnings through accretive acquisitions. Many of their investment models focus on reducing the cost structures of acquired dealerships and introducing new products and more efficient selling systems across an expanding portfolio of dealerships. These buyers believe size will be a key component to their success in an evolving auto retail market.

*“We believe scale is key to future mobility and personal transportation solutions...We will continue to grow revenue through acquisitions, generate compelling returns on our investments and deploy additional cash flow to leverage our scale and drive innovation.”*

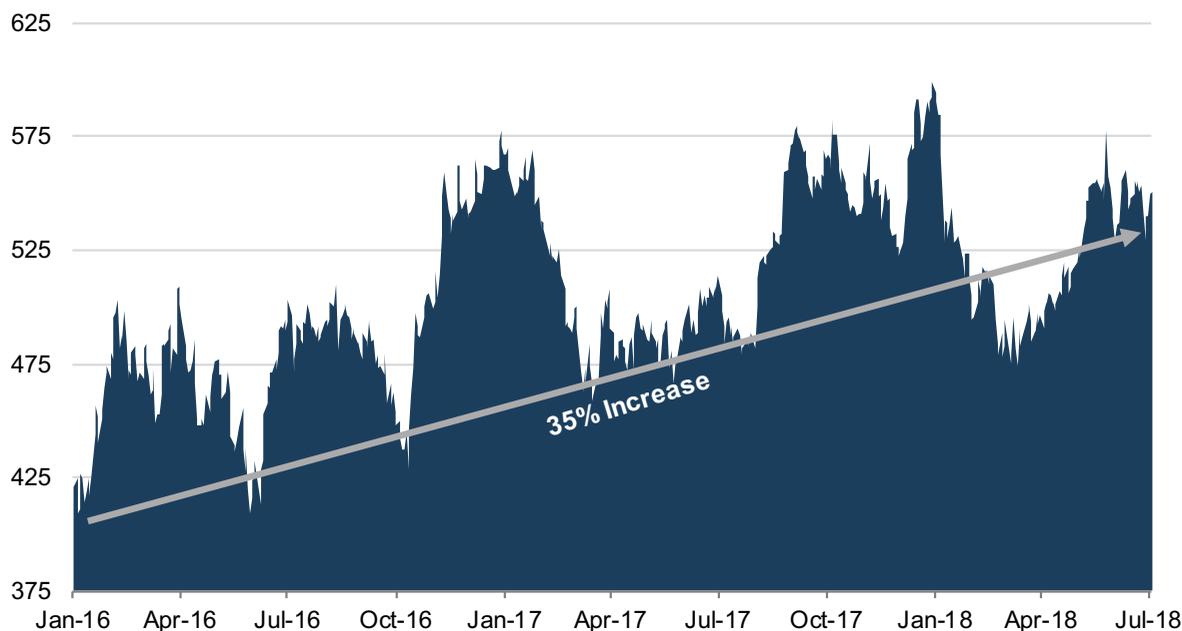
**Bryan DeBoer, President & CEO**  
**Lithia Motors**  
**Second Quarter 2018 Earnings Call**

As a testament to the opportunity for industry consolidation, The Kerrigan Index™ continues to rise despite a plateauing SAAR. It appears that Wall Street also believes that scale matters and the anticipated disruptions to auto retail will disproportionately benefit the largest dealership groups.

**Chart V**  
**The Kerrigan Auto Retail Index**  
**January 2016 – July 2018**

Source: Yahoo Finance and Kerrigan Advisors Analysis

<b>The Kerrigan Index™</b>	<b>550.23</b>
<b>(7/31/18)</b>	
<b>Change from January 2016 Low</b>	<b>35.1%</b>



With this backdrop, Kerrigan Advisors expects 2018 to be another highly active buy/sell market, framed by the trends discussed in our prior reports, as well as the following three trends reviewed herein. We expect these trends to have a significant impact on the buy/sell market for the remainder of 2018 and into 2019.

- Consolidators focus on geographic concentration
- Successful business models command higher blue sky
- Expense reduction becomes a major consolidation driver

The Blue Sky Report® is informed by Kerrigan Advisors' experience representing our sell-side clients in today's buy/sell market, as well as research conducted by our firm. Kerrigan Advisors is the most active, licensed sell-side advisor to auto dealers in the industry. Since 2015, Kerrigan Advisors has advised on the sale of 72 dealerships, including five of the Top 100 Dealership Groups in the US. Our firm works exclusively for sellers of higher value dealerships and dealership groups. We have had the pleasure of working with auto retail's leading families in determining the right time to sell and the most appropriate buyer for their dealerships.

We do not take listings or maintain inventory, rather we develop a customized, professional sales approach for each client to maximize transaction proceeds. Our team oversees and manages our clients' sale process from the beginning through a successful closing. In our view, *dealerships are far too valuable to be sold any other way.*

We hope you find the information presented in this quarter's report helpful to your business. We look forward to answering any questions you may have regarding The Blue Sky Report®, The Kerrigan Index™ or Kerrigan Advisors' sell-side, capital raising and consulting services for auto dealers and their families.

# THE BLUE SKY REPORT

A KERRIGAN QUARTERLY



If you would like to read the full report,  
please visit our website:

[www.kerriganadvisors.com/theblueskyreport](http://www.kerriganadvisors.com/theblueskyreport)