WHERE THE RUBBER MEETS THE ROAD

2014 Annual Market Profile of the Automotive Dealership Landscape

“Get your motor runnin’
Head out on the highway
Lookin’ for adventure
And whatever comes our way.”

-Born to Be Wild, Steppenwolf
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LETTER FROM THE PRESIDIO TEAM

We are pleased to present The Presidio Group’s 2014 Annual Market Profile of the automotive dealership landscape which we have entitled, *Where the Rubber Meets the Road*.

We chose that title because our goal through this communication is to provide you with real, actionable and value-added information, rather than inundate you with pages of charts and statistics.

The big takeaway in this edition is:

**Focus on the REAL drivers of value for your dealership and stop paying attention to multiples based largely on guesswork.**

These value drivers are both qualitative and quantitative and when taken together, work to establish the true value of your business in today’s market. This method of calculating valuation is equally useful to owners looking to unlock the capital being utilized in their current business, and acquirers seeking to expand their current network of dealerships through acquisitions. The Presidio Group has been helping dealers do both for nearly two decades.

This issue opens with a casual, yet informative, Q&A with Brodie Cobb who is not only the founder and the head of our automotive and truck advisory practice, but also has more experience than almost anyone in the industry when it comes to understanding the ins and outs of the dealership marketplace. His thoughtful comments address some of the thornier aspects of dealership ownership.

As always, we stand ready to answer any questions you may have and look forward to keeping in touch. So reach out and let us know how we can help you. The incredible market we are currently enjoying will not last forever!
Brodie Cobb founded The Presidio Group in 1997 and was one of the first investment bankers to focus on transactions in the automotive retail sector. To date, The Presidio Group has worked on dealership transactions worth more than $3 billion and remains a leader in the automotive retail sector.

Q: Is this a good time to sell?

The short answer is an emphatic “Yes!”

At the risk of boring you with statistics, please indulge me for a moment: Private and public dealerships bought 200 franchises in 2013, and 2014 transactions are outpacing 2013 by 64%. During this time, the six public retailers alone spent almost $2 billion acquiring additional dealerships.

This unprecedented level of demand is being driven by three main factors: First, the cost of debt is at historic lows, meaning that lenders are willing to extend credit at prices and terms which make acquisition funding very attractive; Second, the cost of equity is also at all-time lows with the rising stock prices and price/earnings multiples of the public auto retail consolidators at all-time highs; and, Third, most stores’ pre-tax earnings are at or near all time highs.

These three factors underpin the incredible run we are seeing in the dealership market.

Q: Well, what goes up must come down, so what do you see as the challenges dealerships will face in the coming years?

I don’t have a crystal ball, but as Mark Twain once said, “History doesn’t repeat itself, but it does rhyme.”

As such, I see two things on the not too distant horizon that can be challenges. The first is interest rates. We all know that rates have been kept artificially low by the Federal Reserve and that at some point they will begin to rise. Nobody knows when or how severely they will rise, but I’ve been around long enough to know that it will happen. It’s a double-whammy for auto dealership valuation because the cost of capital goes up and pre-tax earnings go down. Therefore, by our estimates, a 1% rise in interest rates can lead to a 10% or greater decrease in a dealership’s valuation depending, of course, on each dealership’s respective situation.

The second challenge is what we call the “rebound effect” coming off of the financial crisis of 2008. The dramatic rise in automotive sales from 2010 to 2013 is simply unsustainable, and we should see lower sales growth over the next three years.

An increasing cost of capital in the coming years coupled with diminished levels of sales growth will inevitably lower dealership profits and valuations.

Q: What is the biggest obstacle for a founder thinking about selling his or her dealership?

You’d think it would be price, but it’s not. It’s emotions. That may sound crazy, but think about it for a minute. Successful dealerships are often closely woven into the fabric of their communities and are highly visible and active with local charities. Founders watch the families of their associates grow; they celebrate life’s joyful milestones with them and try to comfort them through tragedy. These organizations are just plain different from other companies. It’s no wonder that owners feel a true sense of obligation to their community, their employees and their customers. Though highly underrated, the emotional component of selling a dealership can be much more difficult to overcome than economic considerations.

After having worked with countless dealership owners, I can say with full confidence that all of these emotions are completely normal. This is precisely why when we work through these transactions, we not only work hard on the economics, but we also work equally as hard to help clients reach a place where they are comfortable embarking on a new chapter in their lives. It’s an extremely nuanced part of the transaction and if you don’t bring a lot of empathy and intuition to the table, you cannot be successful in this business.

Q: What can dealership owners do to increase their valuations?

There are a number of actions owners can take and this is something we think through with clients on a daily basis. While many of these things are intangibles such as the look of the facilities or a dealership’s integration into the community, they absolutely make a tangible difference in a dealership’s valuation. The most important thing for owners to do is understand that these components are based on their own unique circumstances and then think about each of them through the perspective of how a potential buyer will view them when evaluating an acquisition of that business.

Similar to how we value a seller’s emotional considerations, we have spent countless hours with clients advising them on how to best leverage all of the intangibles which affect their individual businesses.
AVOIDING THE “MULTIPLE” PITFALL

Understanding the Many Components of Your Dealership’s Value

In our experience, the single biggest mistake owners can make in evaluating their business is spending too much time thinking about multiples. A multiple, after all, is nothing more than a mathematical ratio that expresses the output of a business’ valuation and fails to take into account a myriad of other factors.

\[
\text{Multiple} = \frac{\text{Total Goodwill (Blue Sky)}}{\text{Pre-Tax Profit}}
\]

The question is: which pre-tax profit? Actual trailing 12 months? Actual prior fiscal year? Estimated forward 12 months? Any of those periods “adjusted” or “normalized” for the new ownership? And on and on and on….

The answer is: Rather than start with what the multiple is, Presidio has come up with six key qualitative and quantitative components that we believe are the true drivers of a dealership’s valuation, and begin with those. By doing this, we are able to work with owners to understand exactly what their valuation is comprised of and can then provide them with the very best advice on the way forward.

These six components include the following:

**Brand**
As professionals in the automotive sector, we have all witnessed the volatility of automotive brands over the years. In 1999, people thought Audi was dead and today it is one of the hottest franchises in the U.S. Similarly, in the late 1990’s, the value of a Ford franchise was roughly equal to that of Toyota and Honda. By the early 2000’s, however, its value had fallen precipitously, yet today a Ford franchise is worth at least double from its low.

Because a brand’s importance to valuation cannot be understated, there are a number of qualifying questions to consider, including, but not limited to: consumer desirability of the brand’s current and proposed products; the manufacturer’s relationship with and commitment to its

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**Presidio’s Brand Listing**
Based purely on the current buyer demand that Presidio has observed, we have classified certain franchises into three categories listed below. Category A represents brands that currently have the greatest demand, while Category C represents brands which are currently less desirable. Be aware, this list is not set in stone and the desirability of each brand can fluctuate based on other value drivers we outline in this newsletter.

**A Brands**
- Audi
- BMW
- Honda
- Mercedes

**B Brands**
- Ford
- Land Rover
- Hyundai
- Nissan
- Kia

**C Brands**
- Mini
dealer network as evidenced by advertising spend, sales incentives, warranty policies, product availability and facility requirements; captive finance arm cooperation; among many others. See the sidebar on the previous page for Presidio’s analysis of current brands.

Market
The old adage “location, location, location” applies to the automotive retail sector just as much as it does for the real estate business. A comprehensive look at the density and growth rate of the population, traffic patterns, community adoption of specific brands in specific markets, as well as the demographics of a given community, are key factors in determining an ultimate valuation. One must also take into consideration the number of competitors in a given area, as well as the economic health of a particular market.

People
Like so many businesses, the success of a dealership is closely tied to the people who operate it. Buyers want to know that either the leaders or employees who have built the business are likely to stay on board following a change of ownership or that buyers are able to attract and retain new successful management.

Facility
A dealership’s facilities represent a major investment and ongoing expense for owners. A facility reflects a dealership’s brand and is critical in attracting and retaining customers. When evaluating the impact of the facility on a dealership’s value, we look at how the facility has been maintained, whether it meets the manufacturer’s image requirements, and whether the space is adequate to meet current demand and support future growth. It’s also important to identify any potential issues, such as environmental problems or deferred maintenance, that may need to be addressed.

Presence
As referenced in the interview on page 4, automotive dealerships occupy a unique place in the community in which they operate. Although this is an intangible, it holds tremendous value and needs to be analyzed. Factors that determine the value of this presence include a dealership’s traditional and digital marketing activities, the frequency of its advertising and, importantly, whether the community views the dealership as a good, contributing corporate citizen.

Performance / Return on Invested Capital (ROIC)
Now that we have discussed the more qualitative factors in assessing a dealership, it’s time to look at some numbers. When determining a buyer’s ROIC, we have to determine the buyer’s cost of capital, develop pro-forma projections, and then calculate an ROIC matrix. Finally, we benchmark that data against information from previously closed transactions.

It is only after all of these components are taken into consideration that a seller can understand the true value of their dealership and come up with the correct price and multiple it deserves. If you ignore the factors listed above and focus purely on “multiple” alone, you are only getting part of the story.

Please feel free to contact anyone of us on The Presidio Group team if you would like to discuss how to conduct a similar valuation of your own dealership.

Private and public dealership groups purchased 218 franchises year to date in 2014, outpacing 2013 by 64%
Does this chart seem a little counter-intuitive based on the desirability scale of franchises?

Not at all! The buyers of the less desirable franchises took advantage of strong availability and paid prices based upon expected ROIC using lower capital investments, just the way Presidio coaches our clients in developing accurate valuations of their businesses. Smart buyers put their money to work where the returns are best. And today the best returns are probably coming from the highest transaction volume brands.

The Presidio Group LLC is an independent financial services firm focused on wealth advisory, investment banking and private equity. The firm was founded in 1997 with the simple mission to relentlessly put the interests of its clients first. By steadfastly adhering to this philosophy, the firm has earned the trust of clients throughout the United States. The firm’s seasoned and intellectually honest professionals create client relationships based on mutual respect and a commitment to long-term results. Today, The Presidio Group has approximately $4.4 billion under advisement, 60 employees, and offices in San Francisco and Dallas.

Presidio uniquely focuses on the life cycle of entrepreneurs which gives us a better perspective and understanding of the challenges and opportunities our clients face.

Investment Banking
- Corporate advisory with emphasis on M&A and private capital raising
- Focus on entrepreneurially led small to middle market growth companies

Wealth Advisory
- Endowment-style investment advisory for select endowments, foundations and wealthy families
- $4.4 billion under advisement
- Over 150 clients in 20 States

Private Equity
- Fund I $45mm Vintage 2007
- $3mm - $15mm per investment; sector and geography agnostic
- Experienced team has deployed over $1b in capital

www.thepresidiogroup.com
AUTO AND TRUCK INVESTMENT BANKING TEAM

The Presidio Group brings its unmatched experience in auto dealership M&A, sophisticated financial knowledge and relationship-driven approach to every client we serve. During our careers, we have closed more than $3 billion in auto dealership transactions, and are well-versed in the often emotional process involved in selling and buying a dealership. Ultimately, with The Presidio Group by your side, you can focus on the business, while we work to optimize the transaction structure and terms on behalf of our clients.

Because we are an investment bank, not a dealership brokerage firm, our clients receive thoughtful and insightful advice tailored to help them attain their individual strategic goals. Our services include: market assessment, financial analysis and valuation, offering materials, deal structure and negotiation, and even advising on OEM and employee communications.

Brodie L. Cobb, Founder, Executive Chairman, Head of Auto and Truck Group

Brodie leads Presidio’s auto and truck investment banking practice. This is an area that Brodie has been passionate about since before he founded the firm in 1997. Back then, Presidio was one of the first investment banks to focus on transactions in the automotive retail sector. Today with more than 50 individual transactions totaling over $3 billion, it is also one of the most experienced and respected firms in this arena. Prior to Presidio, Brodie was an investment executive focused on the automotive sector at NationsBanc Montgomery Securities where he helped to take public three of the largest entities in this sector – United Auto Group (now Penske Auto Group), Sonic Automotive, and Group 1. He began his career at Security Pacific Bank’s LBO Funding Group. Brodie earned his M.B.A. from the University of Texas and B.A. degree from Tulane University. He competed for a spot on the 1988 U.S. Olympic Team in sailing, races bicycles, and serves on the Board of Directors of Southwest Securities, Inc.

James “JT” Taylor, Managing Director

JT joined The Presidio Group as the primary relationship manager for our auto and truck investment banking clients. During his more than 30-year career in the automotive industry, he has worked on both the retail and manufacturer sides, developing deep relationships throughout the U.S. and Canada. Prior to Presidio, JT led product planning for Toyota in North America and was also part of the Lexus launch team. JT was an operating partner in a number of successful dealerships and worked with Joe Gibbs Racing, Southeast Toyota distributors, and the Wolfington Companies in a variety of automotive opportunities. JT earned his B.A. in economics from the University of Cincinnati. JT and his wife enjoy their six adult children and serving at their church. He follows motorsports with a passion and will go to a race of anything with four wheels and a motor.

Doug Stewart, Senior Consultant

Doug joined Presidio in 2014 as a senior consultant on the auto and truck investment banking team. Prior to Presidio, he was the West Region Chief Financial Officer for Group1 Automotive for eleven years responsible for twelve import, luxury and domestic auto dealerships all located in California. Prior to Group1, Doug was the CFO for thirteen years for a private dealer group with six Japanese franchises in Southern California. In his 25-year tenure as an automotive group CFO, he was involved in twenty six acquisition, disposal and termination transactions valued at $240 million. Doug is a CPA and worked for one of the “Big Eight” accounting firms for nine years. Doug earned his B.S. in accounting from the University of Southern California. Doug is involved in amateur sports car road racing and races a Spec Racer Ford. He also enjoys golfing and cycling and is an avid hockey fan.

Vladimir Babiuc, Analyst

Vlad joined Presidio in 2013 as an investment banking analyst focusing on M&A and capital raising advisory services. Prior to Presidio, he was an investment banking analyst at AGC Partners, financial advisor at Morgan Stanley, and investment banking analyst at Versailles Group. Vlad earned his B.S. in Finance from Bentley University. Vlad competed for the U.S. National Team in Olympic Style Pistol Shooting at various competitions around the country, setting two national records and winning over 30 medals and awards, including two gold medals at the National Junior Olympic Championships.
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