



# Truist Dealer Insider

The Automotive Retail Newsletter

Volume 4, Spring 2022

# Welcome to the Spring 2022 issue of the Truist Dealer Insider

Dear Friends,

With a strong start to 2022, dealerships are looking at how they can extend their impressive operating performance from this past year while keeping a sharp eye on valuations and opportunities in M&A.

We are truly in the Golden Age of automotive retailing—operating costs are down, gross and net margins are high, and the resulting cash balances can be used for improvements, acquisitions, or dividends. Interest rates, while moving upward, are still at historic lows, and retail demand may outstrip supply for years.

What's next? Michael Skordeles, Senior U.S. Macro Strategist at Truist Wealth looks at the key metrics for the U.S. economy, including the global events that we should all be watching. To prepare for the day when supply and demand are back in balance, Bill Jones, Head of Truist Dealer Retail Services looks forward to the trends and buying patterns we can expect from the ever-evolving automobile consumer.

M&A continues at historic highs, powered by sellers seeking peak values and buyers assured of the likelihood of post-sales profits. We'll take an in-depth look at the dealership consolidation wave—including the M&A trends and buyer/seller behaviors behind it—with results from our annual Truist dealership valuation and buyer motivation survey. Thanks to all of you who responded to the survey!

We've also got the latest on the transition from LIBOR, including a review of the emerging benchmark rates and key milestones. Finally, Joe Magyar, CPA, of Crowe LLP reports on the effect of shrinking inventories on tax bills and reviews strategies that may offer relief.

We're in midst of exciting, yet volatile times in our industry. As you're plotting your path forward, we invite you to draw upon the Truist team and the deep roots we've established in our local communities and in the dealership industry. We're uniquely positioned to provide the full spectrum of debt capital structuring, indirect prime and near-prime auto finance, M&A strategy, and business and family transition planning to set you up for success. Let's talk about ways we can help.



Jason W. Smith  
Head of Truist  
Dealer Commercial Services



Bill Jones  
Head of Truist  
Dealer Retail Services



JT Taylor\*  
Head of Automotive  
Truist Securities

\*Denotes licensed with FINRA

## Truist automotive dealer services



~\$50 billion of capital committed to dealers



700+ commercial dealer clients and 15,000+ retail dealer clients



Dedicated resources to support dealers throughout their entrepreneurial lifecycle, including automotive retail investment banking through Truist Securities, dealer commercial and retail services, business transitions advisory, and insurance and risk management.

Check out JT Taylor's recent interview for Automotive News' *In the Driver's Seat*



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Managing Partner, Retail Dealer Services Group, Crowe LLP

# A hot economy feels the pressure from inflation, but not a recession



**Michael Skordeles AIF®**  
Senior U.S. Macro Strategist, Truist Wealth

The U.S. economy remains strong, powered by a robust labor market that's feeling pressure from the escalation of the Russia-Ukraine conflict, which is spiking energy prices. Healthy consumers that a thriving economy supports are good news for automotive retailers looking to continue their run of exceptional performance.

When the pandemic, closings, and health restrictions slammed the brakes on the economy, we hoped for a fast recovery, but we never expected it to be smooth—and we were right. As we look at the key economic elements, inflation is a constant thread, and the Federal Reserve's (Fed) fight to control the pace of the economy will be part of the economic storyline for the immediate term. A robust job market spurs both inflation and growth.

The U.S. is running at full employment as the unemployment rate fell to 3.6%, in line with December 2019. Private payrolls increased by 426,000 workers in March 2022, while government payrolls rose by 5,000 as sizable numbers returned to the labor force. Every labor market indicator, including initial jobless claims, job openings, quit rates, and others point to the strength of the labor market.

Wage and income growth increased as average hourly earnings rose 5.6% from a year ago. That's well above the 2019 average of 3.3% and double the 2.4% average for the decade before the pandemic (2009 through 2019). Gains are even stronger for rank-and-file workers—the bulk of all employees—who are seeing increases of 6.7% year over year.

Wage gains are a double-edged sword—while they push inflation higher in the short term, they also drive gross domestic product (GDP) growth somewhat higher in the next year. Wage gains should be a modest net positive for long term growth.

## Average hourly earnings of production & nonsupervisory employees (year-over-year change)



Source: Truist IAG, Bloomberg, Bureau of Labor Statistics

## Economic data remains strong.

Demand remains robust, which implies further growth rather than recession. Look at weekly jobless claims, the unemployment rate, housing starts, building permits, and manufacturing surveys—all those indicators are pointing toward continued economic growth (and inflation) rather than signaling recessionary conditions. We expect real GDP growth of 2.2% year over year, marked down to account for hotter inflation and faster-than-expected Fed hikes in 2022.

Credit quality continues to normalize, up from the all-time lows that primarily affected low credit score customers in 2021. Still, overall credit quality remains stellar considering the pandemic.

### **Inflation is “the” hot button issue for consumers and businesses.**

The inflation that we’re seeing today will likely persist, especially with already high energy prices being further aggravated by the Russian invasion.

Outside of energy, other upward inflationary pressures are generally cooling. For example, rents are moderating from a red-hot 2021, used car prices have declined for two months (February and March), and wage pressures have softened.

While we expect overall inflation pressures to ease later this year as production and supply chains recover and consumer spending shifts back towards services, for 2022, we’re projecting the Consumer Price Index (CPI) to rise 6.8%.

### **Watching the Federal Reserve and stock market**

The Fed will remain laser focused on inflation, and the hotter inflation readings have bolstered its stance. That translates to faster-than-expected rate hikes in 2022 to combat inflation and also reduces growth, on the margin, by increasing borrowing costs, particularly for big-ticket purchases.

We now expect the Fed funds rate to be 1.75% to 2.00% by year end 2022, and 2.50% to 2.75% by year end 2023. Furthermore, we expect the Fed to allow balance sheet runoff at a pace of \$80 billion - \$100 billion per month beginning this summer.

While the Fed has signaled its resolve to take on inflation, we believe talk about the Fed “overtightening”—causing a recession—is misplaced. The Fed has many levers to pull, including reducing its balance sheet, as well as adjusting the speed and size of rates changes.

When it comes to the stock market, we expect stock price and yield volatility will likely persist for much of 2022. Between Russia, energy prices, inflation, recession fears, Fed tightening, profit margins, earnings, and mid-term elections later this year, investors can’t easily get a “clean” read on conditions. That’s a recipe for continued volatility.

### **Consumer strength**

The automotive supply shortage is expected to continue for some time due to continued supply chain issues for manufacturers, keeping vehicle prices elevated. Demand should also remain solid so long as the consumer wage growth stays strong and able to absorb elevated car prices and financing costs from higher interest rates. The risk to watch is a recession, and while we see hotter inflation readings lingering for longer and inflation-adjusted growth will be lower in 2022, we don’t see the makings of a recession at present. All indicators point toward an economy that is strong and running too hot, not one headed for a recession. For dealerships and for the economy as a whole, that’s great news.

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# Prepare now for the next era of automotive retailing



## Bill Jones

Head of Truist Dealer Retail Services and CEO/President of Regional Acceptance Corporation

For the past two years, the auto retailing business has enjoyed exceptional performance. Those with the good fortune to be part of the industry have seen record profits driven by supply chain disruptions and an active M&A market with the capital to support growth plans and owner exit strategies alike.

How long can the good times roll? It's hard to say just how long, but we can be assured that at some point, things will change. Given that reality, the plans that dealers put in place now and investments made over the coming year will position dealers to continue their success, no matter what lies ahead.

### A seller's market

To understand potential changes and their impact, it's essential to first look under the hood and see what's been working well for dealers in the past couple of years:

- Margins rose steeply on traditionally lower-margin new cars.
- Unit sales volume shifted toward higher-margin used cars.
- Labor costs for new car sales staffing dropped with fewer unit sales and the shift toward digital buying.
- The U.S. automotive fleet continued to age, requiring more servicing and repair.
- Inventory carry costs remained at historic lows with low floor plan utilization levels.
- Consumer financial health stayed strong, with capacity to borrow and buy vehicles.

More than anything else, auto retailing strength has been supported by an industry-wide vehicle supply shortage and robust consumer liquidity from several rounds of economic stimulus. The result has been the Golden Age of automotive retailing where the power of these positive forces has overwhelmed the industry's intense competitiveness that usually keeps margins in check.

### New vehicle inventories plummet.<sup>1</sup>

Days of new vehicle sales on hand



Most predictions suggest it may take from one to three years for new vehicle inventories to return to historic levels—if they ever do. While conditions can shift quickly—who could have predicted the stellar industry performance of the past two years in April/May of 2020—dealers should have enough time to put in place strategies that can help extend recent successes into the next era of auto retailing.

### The next era

Everyone participating in the automotive retailing business is asking “what’s next,” and there’s plenty of conjecture about where the industry will go. From our conversations with dealers and industry leaders, there are seven trends to watch:

1. **Disrupted buying patterns.** What happens when a buyer’s established pattern is interrupted such that the every-three-year lessee can’t find or afford their next vehicle? In today’s market, retailers are making up in higher margin what they’ve lost in lower volume. That’s fine for now, but

if new car buyers can't buy the way they're accustomed to, they may start to hold vehicles longer, shift to more affordable brands, or eschew new cars for used ones.

- 2. Buying on demand versus walking the lot.** The recent shift toward ordering vehicles versus the traditional process of walking the lot looks to change the basic customer journey from top to bottom—the only question is how rapidly this will happen. Nevertheless, the move to digital buying will put each dealer's development of the digital journey to work and validate those investments. Conceivably, this could open new doors to engaging with—and selling additional services or add-ons to—customers who've made a purchase and are waiting for delivery.
- 3. Rising unaffordability.** The combination of inventory shortages and inflation is threatening the affordability of new cars for many people. Already, we're seeing volume in the price-sensitive sub-prime sector drop by 20-25% in recent months. Affordability is an issue for all buyers across both new and used vehicles, and dealers are watching closely to see how it affects overall demand and the mix by category and brand.

### New vehicle prices are outpacing consumer purchasing power growth.<sup>2</sup>

Weeks of income needed to purchase a new light vehicle.



- 4. Soaring fuel prices.** With the current geopolitical dynamics, higher fuel prices at the pump, and environmental concerns about fossil fuels, fuel efficiency could become a much more important buying consideration that will tilt the market even more toward EVs. Alternatively, a truck or SUV buyer could become a crossover buyer in search of better mileage. It's too early to tell exactly how it will affect the types of vehicles demanded by buyers, but it's a story we need to watch closely.

- 5. Increased service revenue opportunities with the aging of the U.S. fleet.** The scrappage rate of cars on the road didn't change just because we aren't manufacturing enough new cars to replace them. Many of the latest digital tools are effective at better connecting dealers and their customers, making it easier to make maintenance and repair offers that sustain dealership service revenues while offsetting the expected reductions from the longer-term shift to EVs.

- 6. Greater sales efficiency and increased potential of digital channels.** The pandemic ushered in more efficient retail sales models using fewer salespeople as there weren't as many cars to sell and many customers wanted to do more online. The digital sales journey will provide even more opportunities for dealers to fine tune sales models and ramp up cost-effective marketing strategies like social marketing, search engine marketing, and email/text/mail campaigns.

- 7. Stepping up the used car game.** As the market has shifted towards used cars, many dealers have revamped their used car operations, reallocating lot space, getting more aggressive about acquiring inventory, and rethinking wholesale strategies. Having a high-performing used car business will be critical for years to come, and many dealers are setting themselves up to stay competitive with other franchised retailers and public companies specializing in used cars.

### Playing to your strengths

At some point, today's Golden Era will give way to the next era of automotive retailing. While there's much we can't predict, we can be sure that competition in our industry will remain fierce, including players with disruptive distribution models, retail consolidators pursuing greater scale, and new technology-driven competitors all seeking their piece of the auto-retailing pie.

Local dealers have long relied on their unique ability to build relationships with their customers and pursue a more intimate customer journey to buying and owning a vehicle. The most successful ones will leverage that ability to connect with and engage customers with a state-of-the-art digital approach to buying and owning a car capable of winning with today's customers. Coupling a relationship focus with technology excellence will sharpen the way dealers communicate with prospects, demonstrate their value during the buying journey, and earn their customer's ongoing loyalty as an asset for the business.

For the many dealers across the country dedicated to serving their customers, their employees, and communities, there's no higher reward.

<sup>1</sup> Cox Automotive, VAuto, VMA Data, March 2022.

<sup>2</sup> Cox Automotive/Moody's Analytics Vehicle Affordability Index, February 2022.

# Dealership M&A and valuation overview

## Recent noteworthy deals in auto retail M&A

### Carvana (NYSE:CVNA) acquires ADESA U.S.



**Announced:** February 24, 2022  
**Transaction value:** \$2.2 billion

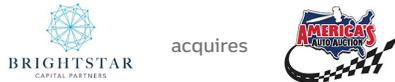
*"Together with Carvana's existing operations, ADESA U.S.'s nationwide infrastructure network and robust, highly profitable business will accelerate Carvana's progress toward becoming the largest and most profitable automotive retailer."*  
 – Carvana Founder & CEO Ernie Garcia



#### Observations and takeaways

- In 2021, the ADESA U.S. business generated over \$800 million of revenue and over \$100 million of EBITDA.
- ADESA U.S. is the second largest provider of wholesale vehicle auction solutions in the U.S. with 56 sites, which total approximately 6.5 million square feet of buildings on more than 4,000 acres.
- At full utilization, ADESA U.S.'s existing and potential reconditioning operations can contribute approximately 2 million incremental units to Carvana's annual production.
- 78% of the U.S. population lives within 100 miles of either an ADESA U.S. or existing Carvana inspection and reconditioning center.

### Brightstar Capital Partners acquires America's Auto Auction and XLerate Group



**Announced:** December 22, 2021

*"We're looking forward to growing this combined company in partnership with our new colleagues from AAA. Our cooperative efforts will allow us to truly become a leading player within the vehicle remarketing sector."*  
 – XLerate CEO Cam Hitchcock



#### Observations and takeaways

- The acquisition combines America's Auto Auction with Brightstar's previous acquisition, XLerate, to create an auto auction business of scale.
- Since its founding in 2000, AAA has expanded to 23 locations across 15 states and developed a comprehensive and trusted auction process, from vehicle reconditioning, through physical or online auction bidding, financing, and check-out.
- Pro forma for the acquisition, XLerate and AAA will have a total of 39 auction sites across 19 states, as well as growing digital and mobile auction businesses and related financing.



**Announced:** September 2, 2021

*"The automotive remarketing sector is poised for tremendous change due to an increased use of technology, evolving vehicle mix and changing expectations from both buyers and sellers"*  
 – Brightstar Partner Gary Hokkanen



#### Observations and takeaways

- XLerate operates through fixed and mobile auction sites across 13 states, as well as through digital platforms.
- The acquisition provides Brightstar with a leading full-service used car auction services provider, delivering a critical liquidity function for the used car sales ecosystem.

| Summary of recent transactions in the auto dealership space |                                |  |                     |               |   |
|---|--------------------------------|--|---------------------|---------------|---|
| Announced date  | Acquirer                       | Target                                   | Region              | Target stores | Transaction commentary  |
| 2/13/22   | Jeff Wyler Automotive Group    | Superior Automotive Group                | Great Lakes         | 7             | Dealerships include Acura, Honda, Kia, and Hyundai franchises. Established in 1924 in Cincinnati, Superior Automotive Group has expanded over the years to serve all of Ohio and Northern Kentucky.   |
| 2/9/22  | Kaminsky Automotive            | Hitchcock Automotive                     | West                | 3             | Transaction included three high-volume Toyota dealerships in Southern California. Kaminsky Automotive is a family-owned car dealership based in San Diego.  |
| 1/28/22   | Gee Automotive                 | Dick's Auto Group                        | West                | 3             | Dick's Auto Group includes Dick's Hillsboro Chevrolet, Dick's Country CDJR, and Dick's Mackenzie Ford. Gee Automotive now owns and operates 18 dealerships in the Portland area.  |
| 1/28/22   | PSD Automotive                 | McDermott Auto Group                     | New England         | 2             | Acquisition consists of auto dealerships David McDermott Lexus and Dave McDermott Chevrolet in New Haven, Connecticut. PSD Automotive owns 31 dealerships.  |
| 1/24/22   | SuperStore Auto Group          | Delray Auto Group                        | Southeast           | 3             | The transaction adds Delray Hyundai, Genesis, and Acura to the SuperStore Auto Group's Essential Ford of Stuart (Florida), Henderson Nissan, Planet Nissan, and Infiniti of Las Vegas.  |
| 12/29/21  | Dobbs Equity Partners          | Papa's Dodge                             | New England         | 1             | Papa's Dodge is a leading new and used automotive dealership in Connecticut and is well positioned to maintain consistent operations with the acquisition.  |
| 12/14/21  | Penske Automotive Group        | Erhard BMW                               | Great Lakes         | 1             | Erhard BMW is the largest BMW dealership in Michigan and will be the Penske Automotive Group's 48th BMW dealership worldwide.   |
| 12/13/21  | Ed Morse Automotive Group      | Norman Roy and Sellers-Sexton Automotive | Plains, Great Lakes | 4             | The acquired locations include Red Bud and New Athens, Illinois, as well as one in Saint Robert, Missouri. The deal represents Ed Morse's second expansion into Missouri, providing a new total of 27 dealerships, 51 franchises, and 14 automotive brands. |
| 12/13/21  | Team Automotive Group          | John Greene CDJR                         | Southeast           | 1             | Following the acquisition of John Greene CDJR, Team Automotive Group will have six franchised automotive dealerships throughout North Carolina featuring the Chevrolet, Buick, GMC, and Chrysler Dodge Jeep Ram brands.                                     |
| 12/9/21   | Automotive Management Services | AutoFair Automotive Group                | New England         | 8             | AutoFair owns seven dealerships and one collision center in New Hampshire and Massachusetts. Dealerships include the Ford, Honda, Hyundai, VW, Nissan, and Subaru brands.   |
| 12/8/21   | Asbury Automotive Group        | Stevinson Automotive                     | Rocky Mountains     | 8             | Stevinson operates eight franchises in the Denver market. The deal adds approximately \$715 million in annual revenues for Asbury Automotive Group.   |
| 12/7/21   | Morrie's Automotive Group      | Barry Merrill Dealerships                | Great Lakes         | 2             | The deal adds Ford and Lincoln dealerships and establishes Morrie's first franchises in Michigan.   |
| 11/17/21  | Lithia Motors                  | Qvale Automotive Group                   | Southeast           | 2             | The acquisition included two Audi dealerships located in Coral Springs and Ft. Lauderdale, Florida and will expand the Company's footprint to consumers in the greater Florida markets.   |

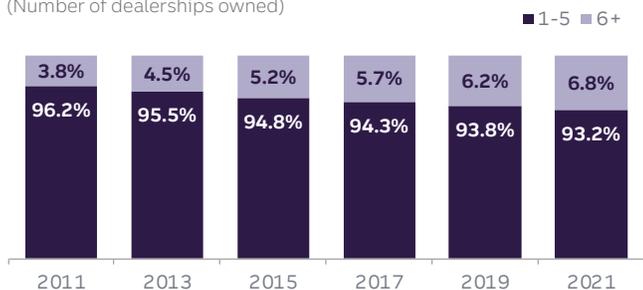
Source: Industry News

# Robust M&A activity continues, with potential headwinds to future valuations

## M&A activity is at historic highs.

### Steady pace of consolidation continues

(Number of dealerships owned)



- 2021 saw a record number of dealership transactions, with 339 closing by year end (123 occurring in the fourth quarter).
- M&A transaction volume increased 68% from 2017 to 2021.
- Anchored by future profitability, blue sky valuations remain strong and create compelling exit opportunities.
- Small dealer groups are weighing a “grow or go” decision as they consider their competitive situation versus dealers of scale and project the need for future capex investment to revamp product and service offerings in the transition to EV.

## Downward pressure on blue sky valuations

The threat of hawkish Federal Reserve policies and slowing public retailer M&A activity may advance the decision to monetize dealership assets in the current environment.

- **Blue sky reduction** — A 0.25% increase in interest rates requires a reduction in blue sky value of ~\$1 million. (holding cash-on-cash return constant at 15%)
- **Cash-on-cash returns** — A 0.25% increase in interest rates reduces the year 1 cash-on-cash return by ~0.3%. (holding blue sky value constant at \$75 million)

### Rising interest rates may impact dealer valuations<sup>1</sup>

Hypothetical transaction

- Dealership EBITDA - \$15 million
- Purchase price - \$115 million (\$65 million debt + \$50 million equity)
- Blue sky value - \$75 million
- Real estate, assets, fees - \$40 million

#### Potential change in blue sky valuation & year 1 returns

| Change in interest rate | 0.00%  | 0.25%    | 0.50%    | 0.75%    | 1.00%    | 1.25%    | 1.50%    |
|-------------------------|--------|----------|----------|----------|----------|----------|----------|
| Blue sky reduction      | \$0.00 | (\$0.90) | (\$2.00) | (\$3.00) | (\$3.90) | (\$4.80) | (\$5.80) |
| Cash-on-cash returns    | 15.00% | 14.70%   | 14.40%   | 14.10%   | 13.80%   | 13.50%   | 13.20%   |

### 3-year forward price-to-earnings ratio<sup>2</sup>



- Publicly traded automotive retailers are valued primarily by earnings per share, organic and acquisitive growth strategies, and technological/digital innovation.
- Relatively depressed P/E ratios may eliminate the accretive nature of premium-priced dealership acquisitions.
- While debt financing costs remain near historical lows, a rising interest rate environment presents a headwind to capital-intensive acquisitions.
- Reduced competition for dealership assets may have a spill-over effect, negatively impacting blue sky multiples.

Source: Industry News, Company Filings, Capital IQ

<sup>1</sup>Y1 cash on cash return defined as EBITDA generated in Y1, less total debt P&I payments, divided by total equity invested

<sup>2</sup> Price-weighted Auto Retailer Index includes AN, ABG, GPI, LAD, PAG and SAH; Market data as of 3/29/2022.

# Public dealership valuation and performance

## Market commentary

- Equity buyers are looking through “peak last twelve months (LTM) earnings” and valuing equity using 2023+ earnings estimates.
  - Valuation multiples have contracted in recent months as investors weigh sustainability of recent earnings.
  - Automotive retailers are generating a significant amount of free cash flow, which has buoyed franchised retailer stock price performance relative to independent retailers.
- Recent M&A has continued to act as a strong driver of earnings growth, with the market rewarding well-executed consolidation strategies by Lithia and Asbury.
  - Acquisition strategies are likely to become more opportunistic, with emphasis on strategic consideration or near-term synergies.
  - Capital allocations may shift toward share buybacks, shareholder dividends, and omni-channel investments.
- Valuations of independent retailers Carvana, Shift, and Vroom have eroded recently, with investors placing emphasis on assets that are cash flow positive amidst the current inflationary environment.

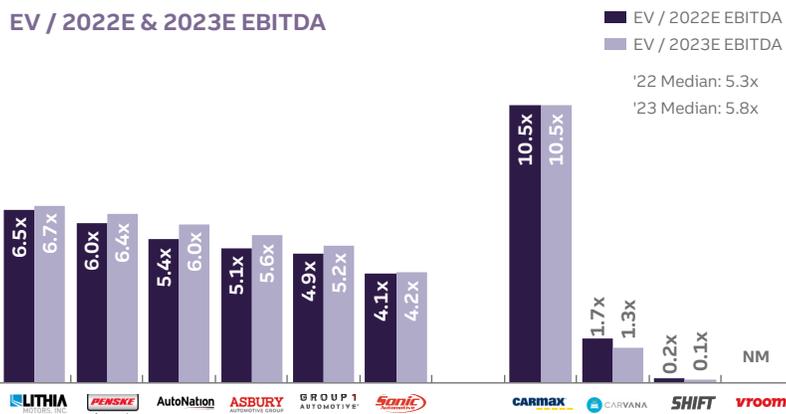
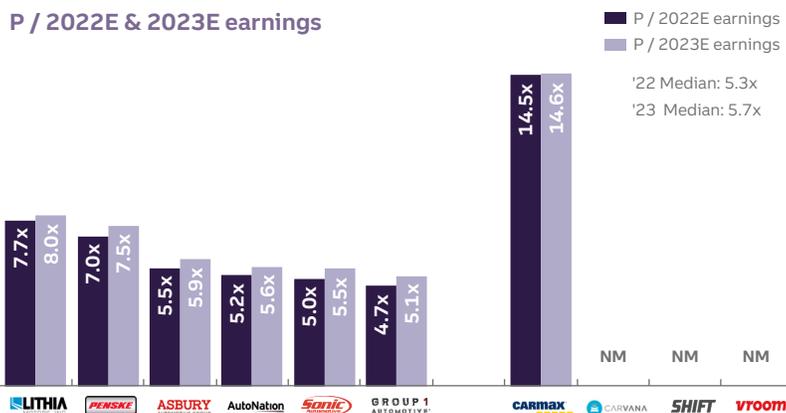
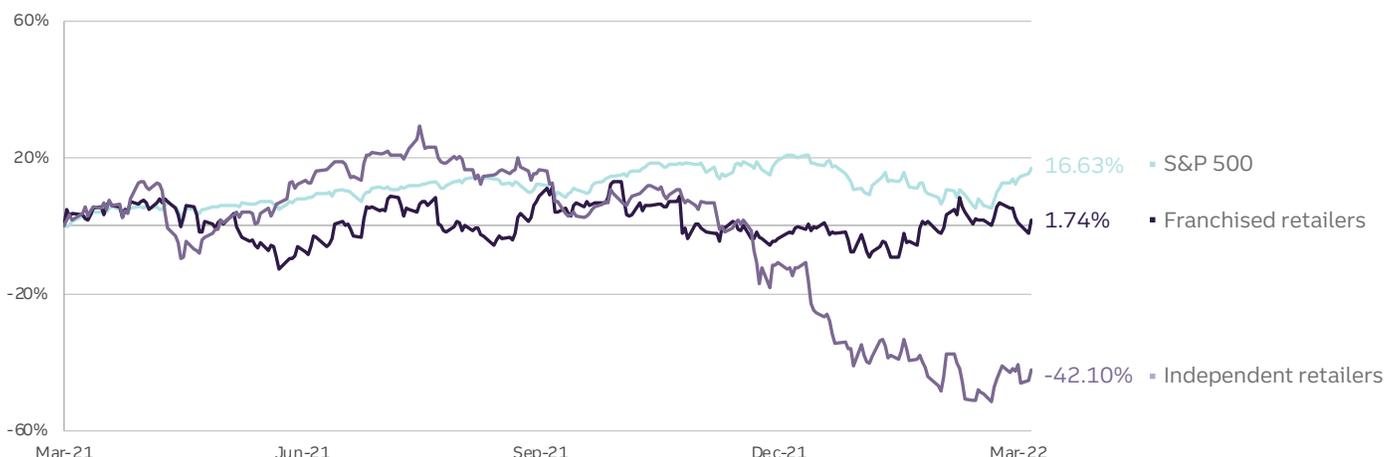


Chart represents multiple of revenue for CVNA, SFT and VRM

## 1-year stock price performance



Source: Capital IQ; Market data as of 10/29/21

# Truist Blue Sky Index

Blue Sky multiples are trending higher

**Truist estimates for brand valuation include a mix of precedent transactions, Truist Blue Sky Index Survey results, and industry observations.**

The table below represents our estimate of the multiple of earnings before interest, taxes, depreciation, and amortization (EBITDA) that a motivated buyer participating in a competitive sales process would pay to acquire the goodwill or “blue sky” portion of a franchised dealership. Public and private transaction data supplemented with a survey of Truist’s dealership clients informs the valuation ranges. The multiples reflect the estimated standalone value of a brand and are not inclusive of a dealer group “consolidation premium”, which typically adds an incremental 0.5x – 1.0x to the implied blue sky value of the group.

Blue sky multiples and valuations have generally drifted higher since late 2020, primarily a result of sustained dealership profitability and upward revisions to future cash flows, a high level of M&A activity driving competition for dealership assets, and access to capital at near historically low interest rates. Leading Premium and Leading Mainstream brands have all held or increased their valuation multiples as their higher sales volume, profitability, and attractive product lineup have led buyers to expect a higher rate of return on investment.

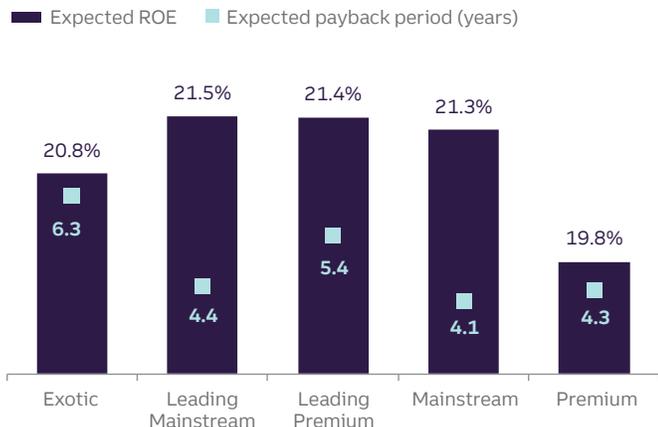
We expect blue sky multiples to remain steady for the next twelve months, but are monitoring the potential impact on franchised dealerships from a rising rate environment, increased OEM supply, and the proposed shift to EV products & services.

| Brand              | Change 2020 - 2021 | % Change | TBI multiple of EBITDA |      |      |
|--------------------|--------------------|----------|------------------------|------|------|
|                    |                    |          | Start                  | End  |      |
| Leading Premium    | LEXUS              | 0.5x     | 6%                     | 8.0x | 9.5x |
|                    |                    |          |                        | 7.3x | 8.8x |
|                    |                    |          |                        | 6.5x | 8.0x |
| Premium            | PORSCHE            | 0.5x     | 7%                     | 7.5x | 9.0x |
|                    |                    |          |                        | 6.0x | 7.5x |
|                    |                    |          |                        | 4.0x | 5.5x |
| Leading Mainstream | TOYOTA             | 0.5x     | 8%                     | 5.8x | 7.3x |
|                    |                    |          |                        | 5.0x | 6.5x |
|                    |                    |          |                        | 3.5x | 5.0x |
|                    |                    |          |                        | 3.5x | 5.0x |
|                    |                    |          |                        | 5.0x | 6.5x |
|                    |                    |          |                        | 4.0x | 5.5x |
|                    |                    |          |                        | 3.5x | 5.0x |
| Mainstream         | SUBARU             | 0.8x     | 15%                    | 5.0x | 6.5x |
|                    |                    |          |                        | 4.0x | 5.5x |
|                    |                    |          |                        | 3.5x | 5.0x |
|                    |                    |          |                        | 3.5x | 5.0x |
|                    |                    |          |                        | 3.5x | 5.0x |
|                    |                    |          |                        | 3.5x | 5.0x |
|                    |                    |          |                        | 3.3x | 4.8x |
|                    |                    |          |                        | 2.8x | 4.3x |

Source: The Banks Report, Cox Automotive, Industry News

# Truist "State of the Market" Survey results

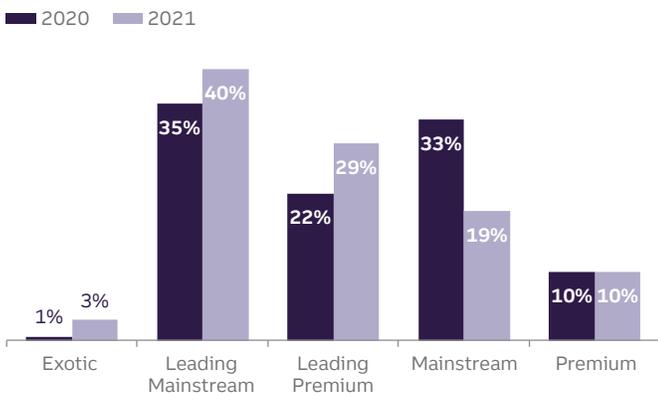
## Expected returns are higher across all categories.



- Expected returns have increased for all categories since late 2020, potentially reflecting an expectation of increased dealership profitability.
- Leading Premium & Leading Mainstream brands top expectations for buyer's return on investment in the first year of operations.

## Leading Premium and Leading Mainstream brands continue to be the most desirable.

### "Shopping List" brand category trends 2020 -> 2021



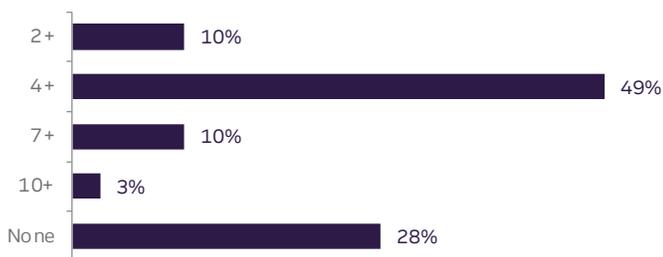
- The top 5 brands on the "Shopping List" were unchanged from 2020's survey.
- Profitability and strategic fit were the primary drivers for inclusion.
- Leading high-volume mainstream and premium brands were the most desirable

**"Shopping List" top 5 brands**

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1. Toyota
2. Lexus
3. Mercedes-Benz
4. BMW
5. Honda

## Number of stores dealers say are needed to receive a consolidation premium.

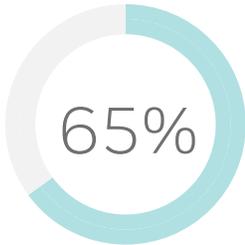
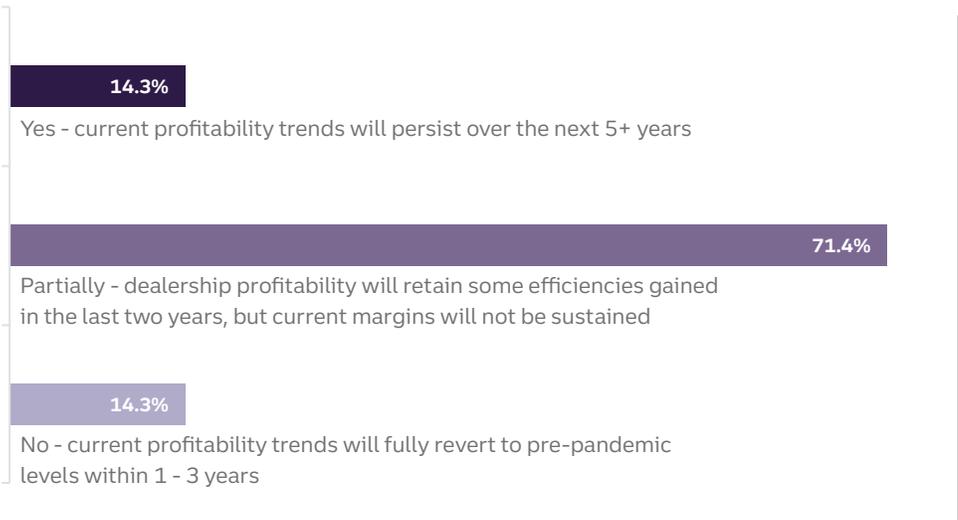


- The consolidation premium assigned ranged from 0.2x – 1.4x and averaged 1.0x.
- 72% of respondents believe a consolidation premium should be applied to dealer groups, (up from 55% in 2020)

## Truist “State of the Market” Survey results: current trends

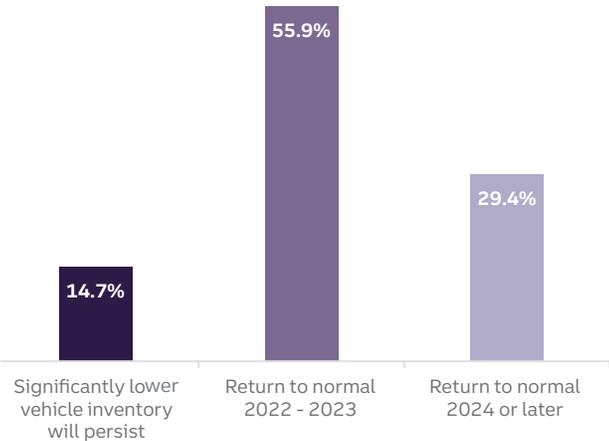
Many dealers have reported strong margins and increased profitability in 2020 and 2021, with supply chain effects on dealer pricing playing a big part. Going forward, most dealers believe that overall profitability will retain some of the efficiencies gained during the last two years.

### Dealers expect future profitability to exceed historical levels, even if lower than today.



of contemplated acquisitions partially discounted the offer price to reflect expectations of reduced future performance

### The majority of dealers expect inventory shortages to be resolved by 2024.



- Only 15% of dealers expect reduced inventory levels to persist long-term, with the majority expecting to return to pre-pandemic supply by 2023.
- Dealerships are operating leaner, with 57% of dealers reporting reduced headcount as a result of the pandemic.
- Dealers are embracing a relatively rapid shift in consumer demand for EVs and expect 16.5% of new vehicle sales to be EV in 2025, growing to 33.4% by 2030.

# Truist Securities automotive capabilities

## Sell-side advisory

- Exclusive sell-side advisory role
- Evaluation of potential or existing unsolicited offers
- Negotiation of terms and conditions
- Manage an organized and competitive marketing process in either a targeted or broad auction format depending on client concerns and objectives
- Broad access to financial sponsor/family office investors interested in automotive retail

## Buy-side advisory

- Advisory role for buyer when evaluating an identified and actionable acquisition
- Valuation analysis to support the acquisition
- Negotiation of deal structure and key terms
- Coordinated effort with financing team to evaluate optimal pro forma capital structure

## Financial advisory/capital raising

- Advisory services to determine best strategic alternative
- Private capital raising initiations to support growth or selling minority holders
- Recapitalizations to facilitate management buyouts or succession planning
- Leading equity platform provides a breadth of experience to advise on any equity offering

## Select recent automotive transactions

|  |  |  |   |  |  |  |
|--|--|--|---|--|--|--|
| <p><b>Project Spider</b></p> <hr/> <p>Franchised Car Dealership</p> <hr/> <p>Sell-Side M&amp;A Advisor</p> <hr/> <p><i>In-Market</i></p> | <p><b>Project Huskies</b></p> <hr/> <p>Franchise Dealer Group</p> <hr/> <p>Strategic Advisor</p> <hr/> <p><i>In-Market</i></p> | <p><b>\$700,000,000</b></p> <hr/> <p><b>AutoNation</b></p> <hr/> <p>Active Joint Bookrunner<br/>10-Year Senior Notes</p> <hr/> <p><i>February 2022</i></p> | <p><br/>Sale to</p> <p><b>TEAM</b><br/>AUTOMOTIVE GROUP</p> <hr/> <p>Sell-Side M&amp;A Advisor</p> <hr/> <p><i>December 2021</i></p> | <p><b>\$150,000,000</b></p> <hr/> <p><b>SHIFT</b></p> <hr/> <p>Passive Bookrunner<br/>Conv. Note Offering</p> <hr/> <p><i>May 2021</i></p> | <p><b>\$800,000,000</b></p> <hr/> <p><b>LITHIA</b><br/>MOTORS, INC.</p> <hr/> <p>Senior Co-Manager<br/>Senior Notes</p> <hr/> <p><i>May 2021</i></p> | <p><br/>Sale to</p> <p><b>RV</b><br/>Retailer LLC</p> <hr/> <p>Sell-Side M&amp;A Advisor</p> <hr/> <p><i>March 2021</i></p> |
|--|--|--|---|--|--|--|

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# Dealers bid “goodbye” to LIBOR. “Hello” to SOFR and BSBY



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The sunset of the London Interbank Offered Rate (LIBOR) has been in the works for years, and commercial businesses like auto retailers have been awaiting details on the transition to its replacement.

In March of 2021, the Financial Conduct Authority (FCA) in the UK announced the dates that it would stop publishing LIBOR in favor of a more transparent, market-driven benchmark. Starting January 1, 2022, banks no longer had the option of using LIBOR as a benchmark for new or renewed credit facilities, but rest assured, on existing loans 1-month LIBOR will continue to be published and used until June 30, 2023. That gives borrowers and banks over a year before the deadline to put plans in place to move to a substitute index.

With its endorsement by the Alternative Reference Rate Committee or ARRC, Secured Overnight Financing Rate (SOFR) appears to be a leading successor to LIBOR. The Bloomberg Short-Term Bank Yield Index (BSBY) has also emerged. Truist is closely watching the development of all the market’s reference rates.

## **Dealerships shift from LIBOR.**

LIBOR has been the primary benchmark used for retail dealership loans, including floor plan inventory lines of credit, commercial real estate, and blue sky loans, with a handful of OEM loans priced based on prime rate. As loans renew or new loans are made between January 1, 2022 and June 30, 2023, they will be based an alternative index such as SOFR. Consistent with the recently passed Adjustable Interest Rate (LIBOR) Act, existing LIBOR-based loans expiring after June 30, 2023 will convert to the new benchmark, either following automatic provisions already in place within those loans or by modification before that date.

Each lender—including Truist—will devise its own plans to convert existing loans to the new benchmark. Truist is working on a conversion process to make the benchmark shift as straightforward as possible while not materially impacting all-in interest rate levels.

## **Settling into SOFR and BSBY**

As the SOFR standard is developing, several variations of SOFR—Term, Average, Daily—have surfaced. All of the variations are calculated based on actual, settled transactions within the short-term borrowing markets. Term SOFR is forward looking, like LIBOR, while Average and Daily SOFR are backward looking. The other leading alternative index, BSBY is forward looking in all its variations.

A key difference between SOFR and BSBY is its relative sensitivity to credit risk in the market. SOFR is closer to a ‘risk-free’ rate—since it’s calculated using overnight lending with high quality collateral—while BSBY has a credit risk component since it aims to represent unsecured lending by design. In normal markets, you’d expect SOFR to be a lower interest rate than LIBOR or BSBY, and that has largely held true historically.

| Interest-rate options at Truist |                                     |  |                                  |
|---------------------------------|-------------------------------------|--|----------------------------------|
| Index                           | Terms (tenors)                      | Interest rate structure  | Publisher                        |
| Term SOFR                       | 1, 3, 6, and 12 month               | Set in advance at commencement of the interest period  | CME Group                        |
| Average SOFR                    | 30, 90, and 180 day                 | Set in advance at commencement of the interest period  | Federal Reserve Bank of NY       |
| Daily SOFR                      | Overnight                           | Averaged daily throughout the month  | Federal Reserve Bank of NY       |
| BSBY                            | Overnight and 1, 3, 6, and 12 month | Overnight BSBY fluctuates daily based on the rate that day; for other tenors, rates remain the same over the interest period | Bloomberg Index Services Limited |

For more information about each of these rates and the version process, check out [Moving on from LIBOR](#) on the Truist Resource Center.

As the post-LIBOR era continues to take shape, we're seeing the same complexity of different lenders preferring different indices that we witnessed decades ago before the market settled on 1-month LIBOR as the preeminent benchmark. The process will likely be the same for SOFR—we just need time for the market to settle around the most compelling benchmark. While 1-month Term SOFR seems to be the leading alternative, it's still too early to tell.



### What happens to my loans?

There are different scenarios depending on when your loans originated or will renew. If you have a swap or hedge in place, the benchmark shift will affect your swap as well.

The ARRC governs the LIBOR conversion, and the International Swaps and Derivatives Association (ISDA) regulates swap and hedging transactions. As the June 30, 2023 regulatory deadline approaches, we are working with our clients to devise the easiest and most transparent method to convert to the new benchmark for existing and new loans/swaps, regardless of maturity.

### Looking forward

The LIBOR sunset and SOFR/BSBY arrival present a good opportunity for a strategic capital review. Mapping the conversion to the new reference rates, reviewing existing loans, considering new debt, and thinking about the impact of a rising rate environment makes now the ideal time to engage your Truist Dealer Services relationship manager. Look to hear from us in the coming months as we move your credit facilities to the latest rate benchmarks.

# Lower inventory could mean higher taxes for dealers



**Joe Magyar, CPA**  
Managing Partner, Retail Dealer  
Services Group, Crowe LLP

While dealers may be struggling to find enough vehicles to satisfy customers, those they do sell may be generating higher tax bills than they would like. Depending on your inventory accounting method, shrinking inventories and inflated prices could push profits and taxes higher, at a much faster pace than you might expect.

## LIFO and taxes in a shrinking inventory environment

Most dealerships rely on the last-in, first-out (LIFO) accounting method for inventory. When inventories are stable and auto prices are rising, LIFO keeps taxes low by using the most recent additions to inventory—generally higher priced vehicles—in cost of goods sold so that taxable profits stay low. But when inventory levels drop, cost of goods sold draws from older, lower cost inventory—also called the LIFO reserve—that can create a jump in tax liability. Worse yet, LIFO accounting rules could mean that the hike in taxable income persists into future years.

Some dealerships have already seen this effect on their 2020 tax returns. The hit could be much harder in later years.

## Relief could be on the way.

The good news is that potential action by Treasury may deliver meaningful relief for dealers. Section 473 of the Internal Revenue Code permits a three-year inventory replacement window under certain conditions which is meant to mitigate the negative tax impact of inventory reductions.

Specified conditions include a major interruption to foreign trade that makes replacing the class of covered products difficult or impossible. That's exactly what's happening to automotive dealerships, according to the National Automobile Dealers Association (NADA). The organization has petitioned the Treasury for relief under Section 473, as has the American Institute of CPAs (AICPA) and others, including bipartisan groups from the House and the Senate.

If Treasury fails to provide relief, NADA has stated that it will urge Congress to enact new legislation that would provide similar relief to dealers and launch a major dealer grassroots initiative in support of the legislation.

## Strategies to minimize the hit

Even without regulatory or legislative relief, there are a few ways to limit the damage. While most new-vehicle dealers use the alternative LIFO method (ALM), the inventory price index computation method (IPIC) is also allowable. IPIC historically has delivered fewer tax benefits but has one key advantage—dealers can pool new-vehicle inventory with inventories that may be more stable, such as automotive parts or used car inventory, to dampen the impact of falling new car inventories. Making the switch from ALM to IPIC could soften the tax blow now, but it may limit future benefits and prevents a switch back to ALM for five years.

Revenue Procedure 2008-31 is another pooling strategy for automobiles and light-duty trucks that allows limited inventory changes in one category to offset sharp reductions in another—lessening the impact of deep LIFO reserve reductions that results in higher taxes. There's also the option to abandon LIFO entirely, triggering full LIFO reserve capture and spreading the recapture over four years. This strategy has considerable tax implications in future years but can deliver net short-term benefits in certain situations.

Any change in inventory accounting must typically occur before filing your tax return for that year. With auto inventories reaching historic lows, dealers should estimate the tax implication of changing inventory levels and seek expert advice on the best options for their situation.



Thanks to Joe Magyar, Managing Partner of the Crowe LLP Retail Dealer Services Group, for this special contribution article. Joe has more than 25 years of experience providing tax and consulting services to the dealership industry, especially large multi-point dealership groups.

He advises retail auto dealers on transactional and corporate structuring, business planning, and tax accounting matters. Joe can be reached at 813-209-2435 or [joe.magyar@crowe.com](mailto:joe.magyar@crowe.com).



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