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Public groups go on the prowl in 2007

Jim Henry | January 29, 2007

Several of the biggest publicly owned dealership groups say they will step up their pace of acquisitions this year and in 2008.

"The possibility of getting deals done will be greater in 2007 and 2008 than in 2004 and 2005, with 2006 as a transitional year," says Mike Jackson, CEO of AutoNation Inc. The Fort Lauderdale, Fla., company is the nation's largest dealership group.

David Cosper, CFO of Sonic Automotive Inc., adds: "There is a sea of opportunity in this business. It's hard to know where to aim first, it's that rich."

A return to more acquisitions would end a period of consolidation in which some of the big groups sold or closed more dealerships than they bought. That left those groups with about the same number of, or fewer, franchises and locations than they had in previous years.

The second-largest dealership group, UnitedAuto Group Inc., of Detroit, is an exception to the rule, mostly because of its aggressive acquisition strategy outside the United States. So is the much smaller Lithia Motors Inc., of Medford, Ore. Lithia has bought dealerships at a slow and steady pace for several years.

All about money

Public groups consolidated to restructure and digest - or shed - acquisitions they had made at a much more rapid pace. Acquisitions also largely slowed or stopped in 2005 and 2006 because from the buyers' standpoint, the sellers wanted too much money.

Sheldon Sandler, managing partner of Bel Air Partners LLC, says the best domestic-brand dealership probably would sell for about four times its annual earnings. That likely would be only a starting point for a store that sells a successful import brand such as Honda, Sandler says.

Other factors are a dealership's location and the value of its real estate, says Sandler, whose Skillman, N.J., firm advises public and private owners on dealership acquisitions.

Sonic's Cosper told an industry conference last month that "acquisitions have been fairly high-priced (in 2006) - millions more than I would want to spend."

As of September, Sonic operated 173 franchises in 150 locations. Those totals are down from 192 franchises and 159 locations at the start of 2005, according to company reports.

The Charlotte, N.C., company has revenues of about $8 billion a year, Cosper said. Sonic could grow, mostly by acquisitions, to $11 billion or $12 billion in revenues, he predicted. "That's what we have our eye on over the next few years," he said.

Opportunity costs

The public groups expect acquisitions to pick up in 2007 because they believe sellers will settle for less money. "We think in the next year or so, some of those premiums will start to come down," Cosper said.

Potential buyers argue that rising interest rates and floorplan expenses will help motivate sellers. Other factors:

- Higher capital investment costs, as automakers demand bigger, better, exclusive dealerships.
- Personal factors for dealers, such as retirement, succession planning and divorce.
- Seemingly bottomless troubles for the Detroit 3's domestic brands.

"Capital demand is one of the primary forces that trigger a sale," says AutoNation's Jackson. The company's biggest dealership construction projects cost more than $30 million each, he said.

Sonic's Cosper said dealership improvements can cost $10 million and more.

Franchises with growing sales - Jackson cites Toyota, Honda, Mercedes-Benz, BMW and Lexus - all have plans that require dealer investment so that the retail network can handle additional volume.

"It forces a fork in the road," Jackson told Automotive News. "Do you want to commit to do this longer?"

That is especially true for Detroit 3 domestic franchises, he says.

"The issue for domestics is, the situation is so cloudy," Jackson says. "You don't know where the bottom is. You don't know where the credible plan is that you could factor in, to determine whether the investment is worth it."

Not so fast

Sandler, of Bel Air Partners, says that many dealers in their late 50s talk about pursuing "other interests."

"They're not 'having a good time' in the business any more - which is what they say when they're not making any money," Sandler says.

But that doesn't mean prices for dealerships will decrease across the board, Sandler warns. He notes that most of the public groups are pursuing the same types of stores: large successful import or luxury franchises in expanding Sun Belt markets.

"Competition always drives up price," Sandler says. "The idea that prices will come down is maybe something (public groups) wish would happen, rather than something that will happen."