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Public retailers hunger for import brands

Donna Harris | January 29, 2007

Large public auto retailers are snapping up luxury and import dealerships as the Detroit 3 continue to lose market share.

Import and luxury brands tend to be more profitable than mass-market domestic franchises. Population trends are working in their favor. And Wall Street gives higher marks to the public retailers that acquire such franchises.

Five of the six largest U.S. public dealership groups earn most of their revenues from import and luxury stores. UnitedAuto Group Inc. and Asbury Automotive Group historically had high concentrations of these franchises. But AutoNation Inc., Sonic Automotive Inc. and Group 1 Automotive Inc. are quickly catching up.

"It is a good financial decision," says Sheldon Sandler, managing partner of Bel Air Partners. The Skillman, N.J., investment firm specializes in auto retailing.

Import and luxury brands account for 80 percent of Sonic's revenues. Jeff Rachor, president of the Charlotte, N.C., company, says he expects that figure to rise to 90 percent within three years.

Luxury dealerships yield most of Sonic's revenues, Rachor told Automotive News.

"Sonic is willing to pay a premium for these brands," he says. "But we won't overpay."

Big bucks needed

Rachor estimates that only about a dozen privately owned dealership groups, in addition to the public retailers, have the capital and management expertise to invest $20 million or more in a dealership.

He says some dealerships in recent years have benefited from "irrational pricing."

But, he says, "because the universe of buyers for these premium assets is small, pricing should migrate back to historical norms."

At the same time, Rachor says, many automakers are demanding costly dealership upgrades. As a result, he says, some entrepreneurs are willing to part with coveted franchises at reasonable prices.

"They are not willing to fulfill the demanding capital-expense requirements mandated by the premium manufacturers," Rachor says "The manufacturers won't approve an acquisition until they get a commitment up front to meet facilities requirements.

"It is often a condition of the buy-sell agreement. It is not uncommon to spend $10 million to $30 million on a facilities upgrade or relocation in addition to the purchase price."

Rapid shift

Some public retailers have made rapid adjustments to their brand mix.

"At the beginning of 2006, we said our goal was to shift the mix to 70 percent import and luxury and 30 percent domestic" in unit sales, says Pete DeLongchamps, vice president of Group 1, of Houston.

"We thought it would take three years to do that."

But Group 1 reached that goal in the third quarter of last year, DeLongchamps says. "Our current goal is to move the mix to a 75 to 25 split by the end of 2007," he says.

AutoNation CEO Mike Jackson says domestic franchises represented 65 percent of the Fort Lauderdale, Fla., retailer's revenues when he joined the company in 1999. Now import and luxury brands account for 60 percent of company revenues, he says.

Luxury brands represent 59 percent of UnitedAuto's revenues, says Tony Pordon, a spokesman for the Bloomfield Hills, Mich., company. Import brands account for 92 percent, he says.

For Asbury Automotive, of New York, 82 percent of revenues come from luxury and import brands. "It didn't happen by chance," says Allen Levenson, Asbury's vice president of sales and marketing.

The focus on luxury brands and volume imports such as Honda and Toyota is especially important to public dealership groups, analyst Sandler says.

"Import margins are better," he says. If public groups "buy a Lexus store or Mercedes-Benz store, analysts will applaud and project better margins and results. If they buy domestics, they have to answer to Wall Street. It puts them in a defensive position."

Population trends also favor luxury brands. A recent study by R.L. Polk & Co. notes that the baby boom generation has entered its peak earning years. Baby boomers like the sophisticated technology and performance available in high-end vehicles, the study says.

Many automakers have expanded their luxury lineups to offer vehicles in a broader price range. Lower-end luxury cars and trucks are attracting younger buyers, the Polk study says.

Here to stay

Although the focus of most public groups is on luxury and import brands, the companies say they intend to keep domestic franchises in their product mix.

"We would definitely buy high-throughput domestic stores in good locations," says AutoNation's Jackson. "It is the marginal domestic store or the smaller domestic store that is not part of our strategy."

He says AutoNation's goal is to get a third of its revenues from volume domestic brands, a third from volume imports and a third from premium luxury brands. Now, he says, 40 percent of AutoNation's revenues come from domestic dealerships, 22 percent from premium luxury brands and 38 percent from imports.

"We're not quite there yet," Jackson says "But we're confident that over the next two years, we'll get the rest of the way there."

Success with domestics

Asbury's Levenson says some of the company's domestic-brand dealerships net $3 million to $4 million a year. "We do have very successful domestic stores, particularly in truck country," he says.

The other major public group, Lithia Motors Inc., is not as eager as its competitors to add luxury and volume-import dealerships. The Medford, Ore., group rejects the most sought-after dealerships as too pricey, says CEO Sid DeBoer. Instead, Lithia's strategy is to buy underperforming dealerships in smaller markets.

The company typically acquires dealerships that fetch a 15 percent after-tax return on invested capital, DeBoer says. It has relaxed that standard slightly for luxury and import stores that have potential to grow, he says.

"We'd love to have more of them," DeBoer says.

But DeBoer says prices for some luxury dealerships doubled over the past three years. At the same time, he says, many domestic franchises perform well in the smaller markets in which Lithia does business. And the fortunes of brands rise and fall, DeBoer says.

Domestic brands "may have to restructure, but they will survive and flourish again at some point," he says.

"I look for a long-term return."