Automotive Retail **Strategy**

Market Overview

The automotive retail industry, which is comprised of franchised new vehicle auto dealerships, is the largest retail business in the U.S. by revenue, with over $1 trillion transacted annually.

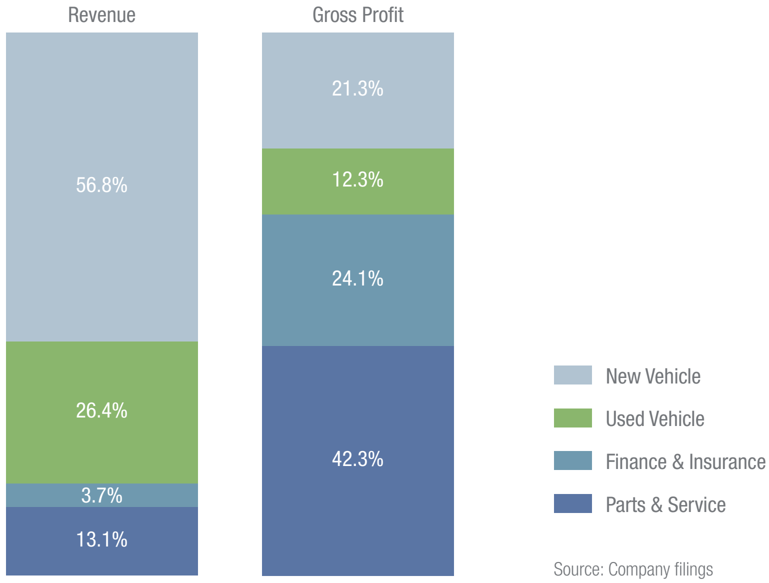
U.S. consumers bought 17.1 million new cars and trucks in 2017. While this was down approximately 2% from 2016, 2017 was the fourth-best year in U.S. history in terms of new vehicles sold.[1] Despite new vehicle sales making up the majority of dealer revenue, gross profit is derived from a variety of sources, as shown in Figure 1. The parts & service and finance & insurance units make up over two-thirds of an average dealership's total gross profit.[2] This diversity in sources of revenue and gross profit serves to insulate the automotive retail industry from the cyclical nature of new auto sales.

The automotive retail industry is highly fragmented, with the six publicly traded auto dealership groups controlling approximately 6.5% of the total market.[3] There were over 16,800 franchised new car dealerships around the U.S. in 2017.[4] This market fragmentation can create opportunities for consolidation by large buyers seeking cost savings and operating synergies.

Over the five-year period ended 2017, automotive retail industry revenue grew at an annualized rate of 4.5%. This strong growth was driven largely by an increase in per capita disposable

Figure 1

Average Public Dealer Revenue & Gross Profit Mix



Source: Company filings

1 Chicago Tribune, *Auto sales remain strong despite record new car prices*, January 2018.
2 Bank of America Merrill Lynch, *Auto Dealer Manual* – 2017, September 2017.
3 Automotive News, *Automotive News Top 150 Dealership Groups*, March 2017.
4 National Automobile Dealers Association, *NADA Data 2017: Midyear Report*, October 2017.

income and rising consumer confidence, which led to an uptick in consumer demand for new vehicles. Additionally, historically low interest rates over the five-year period were a positive tailwind for the industry, as low interest rates make financing a new vehicle more affordable for consumers and help drive "big-ticket" purchases.[5] These positive macroeconomic factors led to record new vehicle sales in 2015 and 2016, as well as the fourth-best sales year ever in 2017.[6]

Looking forward, the automotive industry is facing three large potential changes: a slowdown in new vehicle sales; a shift in vehicle ownership behavior; and the electrification of vehicles. Bank of America Merrill Lynch ("BAML") correctly predicted a peak in new unit sales in 2016 and project a slowdown in sales through 2021.[7] Strong new vehicle sales in recent years, including record years in 2015 and 2016, have dramatically increased the number of 0 – 5-year-old vehicles on the road.[8] We expect that this will be a profit driver going forward, as many of these vehicles are under warranty and therefore, must be serviced at franchised dealers. Additionally, there were approximately 28 million vehicle recalls in 2017.[9] Recalls fall into the category of warranty work and must be performed at new car franchised dealerships. Increased revenue derived from this high margin segment provides support to bottom line earnings and can act as a hedge in times of declining new vehicle sales.

With the advent of autonomous vehicles, combined with ride sharing services, there are some who worry vehicle ownership behavior could change, disrupting the dealership model. BAML foresees partially autonomous vehicles driving additional new unit sales at dealerships, as consumers embrace material improvements in vehicle safety and functionality.[10] In a scenario where private ownership declines materially, which BAML deems unlikely, dealerships are positioned to serve as fleet managers for automakers and mobility services companies. A recent example of this is AutoNation partnering with Waymo, Google's self-driving car affiliate, through a multi-year service agreement. AutoNation's franchised dealerships will provide vehicle maintenance for Waymo's fleet of self-driving cars.[11] This agreement could serve as a model to auto dealership groups going forward to capitalize on the changes brought about by autonomous vehicles.

5 IBISWorld, IBISWorld Industry Report 44111: New Car Dealers in the US, November 2017.
6 Chicago Tribune, Auto sales remain strong despite record new car prices, January 2018.
7 Bank of America Merrill Lynch, Auto Dealer Manual – 2017, September 2017.
8 Bank of America Merrill Lynch, Auto Dealer Manual – 2017, September 2017.
9 CNET, The biggest and noteworthy auto recalls of 2017, December 2017.
10 Bank of America Merrill Lynch, *Auto Dealer Manual – 2017*, September 2017.
11 Automotive News, *AutoNation to provide service to Waymo's self-driving cars*, November 2017.

Electric vehicles have been touted as cost-saving for drivers due to the more durable electric motors and fewer moving parts translating to less maintenance per mile driven. With global automakers preparing to introduce dozens of new electric models over the next five years, some are worried this could have a negative impact on franchised dealerships.[12] However, electric vehicles still make up a small fraction of total new vehicle sales in the U.S. Of the over 17 million new vehicles sold in 2017, approximately 200,000, or about 1.2%, were electric vehicles. While electric vehicle sales have been increasing in recent years, the vast majority of total vehicles on the road remain traditional gasoline-powered cars. This means that most of the 263.6 million vehicles in the U.S. will need regular maintenance for years to come.[13] Additionally, dealership groups with scale will be able to capitalize on the longer-term trend towards increasing electric vehicles on the road by investing in complementary technology and infrastructure. For example, Porsche announced plans in February 2018 to install charging stations for electric vehicles at all its U.S. dealerships.[14] Auto dealerships will continue to invest in new technology to take advantage of changing trends in the automotive retail industry.

Overall, the franchised dealer model remains "fluid, defensive and diversified, and can shift focus to capture growth, profits and returns."[15]

GPB Capital Acquisition Strategy

GPB Capital will seek to acquire 75 – 100 profitable dealerships across the U.S. with a minimum of five years of operating history and build a diversified portfolio of stores (by manufacturer, brand, and geography) with a $5 billion or more annual revenue goal and $125 – $150 million of annual EBITDA. In general, GPB Capital expects to acquire auto dealerships at 3x – 6x EBITDA multiples and provide managerial assistance to aim to increase cash flows.

12 Reuters, *Global carmakers to invest at least $90 billion in electric vehicles*, January 2018.
13 Bureau of Transportation Statistics, *Number of U.S. Aircraft, Vehicles, Vessels, and Other Conveyances*, April 2017
14 USA Today, *Porsche's US dealers will offer fast charging stations for its Tesla-fighting Mission E sedan*, February 2018
15 Bank of America Merrill Lynch, *Auto Dealer Manual – 2017*, September 2017.

Why Automotive Retail?

The overarching investment philosophy of GPB Capital is to seek to acquire companies with strong, consistent cash flows and proven management teams that operate in recession resilient industries with defined barriers to entry and hold them long term. GPB Capital believes that the automotive retail industry demonstrates the following four fundamental criteria.

Current and Sustainable Yield

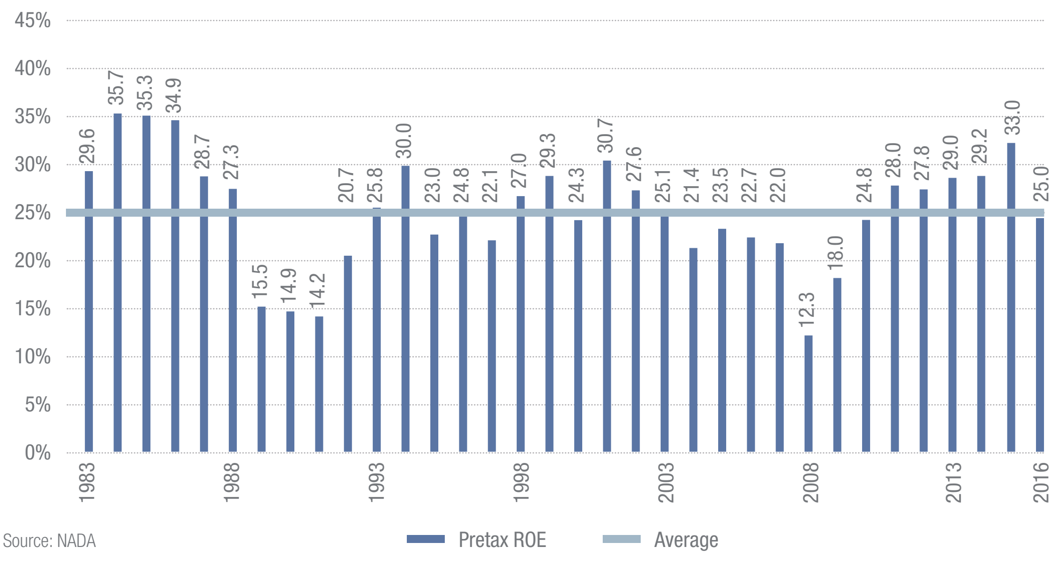
The franchised auto dealership industry has remained highly profitable during numerous economic cycles over the past three decades. As shown in Figure 2, the average pretax return on equity since 1983 for franchised dealerships is 25.4%. Even during the economic turmoil of the Great Recession, the return on equity was 12.3% and 18.0% for 2008 and 2009, respectively.

Recession Resilient

As can be seen in Figure 2, the auto dealership industry has delivered consistent returns during numerous business cycles over the past thirty years. Even as new auto sales fell 18.0% year-over-year in 2008 and a further 21.2% in 2009 amid major auto manufacturer bankruptcies, franchised auto dealerships themselves, on average, remained profitable.[16] GPB Capital believes that this resiliency is the result of diversified revenue streams at dealerships, which are not overly reliant on any one income stream to drive revenue and profit. For example, parts & service, the greatest contributor to gross profit at dealerships, is less cyclical than new auto sales and is more sensitive to miles driven. Total miles driven has historically been only slightly affected by economic conditions, with total miles driven falling only 1.6% from 2007 to 2008 and 0.7% from 2008 to 2009.[17] This fact, coupled with recall velocity noted above, means the parts & service departments can provide a strong hedge against the cyclical nature of new auto sales.

Figure 2

Franchised New Car Dealers' Pretax ROE (Pretax profit % of ending net worth)



Source: NADA

16 USA Today, *Auto sales end 2009 with uptick, but year was awful*, January 2010.
17 U.S. Department of Transportation, *Traffic Volume Trends: December 2016*, February 2017.

High Barriers to Entry

By focusing on industries with high barriers to entry, GPB Capital can target companies that have a certain level of protection from revenue and profit erosion by new competitors. The auto dealership industry is highly regulated by the federal and state governments, and subject to strict capital requirements, as well as operational experience criteria set by the auto manufacturers. Most auto manufacturers deliberately limit the number of franchises granted within geographic areas, making it difficult for new operators to attain a franchise agreement in built-out markets.[18]

When an auto dealership is purchased, the buyer must go through a manufacturer approval process. This process can be very arduous, lasting three to nine months or more. Manufacturers prefer to partner with proven operators, putting GPB Capital at an advantage over other financial buyers, as GPB Capital has developed entrenched relationships across multiple brands. Additionally, every state has different licensing regulations for new car dealers. For example, in the state of California, prospective new car dealers are required to submit to background and credit checks, obtain surety bonds, and provide current franchising agreements.[19] These industry regulations help to prevent new operators from quickly entering the automotive retail market.

Proven Operating Partners

In most cases GPB Capital will seek to acquire a majority interest in franchise dealership groups, generally between 51% and 90% of the company. This acquisition structure leaves existing owners and management teams in place to run the day-to-day operations of the business. GPB Capital will partner with efficient, veteran management teams ("Operating Partners") that have operated within the auto dealership industry for many years and have strong and proven track records. Additionally, as brand and dealership loyalty are very pronounced in the auto retail industry, GPB Capital will focus on keeping Operating Partners in place to maintain the same level of loyalty and avoid any adverse impact on performance of a franchise. GPB Capital's Operating Partners manage numerous franchises in the Top 10 in sales volume nationally and have been awarded for extraordinary customer service by manufacturers.

After acquisition, GPB Capital will work closely with Operating Partners on implementation of a strategic plan, which includes short term and long term operational and strategic improvements within the franchise as well as an integration plan to provide a smooth transition, thus aiming to ensure that GPB Capital provides its best-in-class Operating Partners with the guidance and capital to execute on our shared goals.

18 IBISWorld, *IBISWorld Industry Report 44111: New Car Dealers in the US*, November 2017.
19 Ibid.

GPB Capital

GPB Capital is a New York-based alternative asset management firm focusing on acquiring income-producing private companies. GPB Capital provides their portfolio companies with the strategic planning, managerial insight and capital needed to enable strong businesses to work towards the next level of growth and profitability. GPB Capital seeks to take advantage of the large opportunity in the private U.S. middle-market by investing in companies that have a track record of current and sustainable yield, are recession resilient, have proven operating partners/ management teams and are in industries which have high barriers to entry. GPB Capital's strategies include, but are not limited to, Automotive Retail, Technology-Enabled Services, Debt Strategies, Waste Management, and Special Situations.

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