

**Car dealerships in EU:**

**Which is the most appealing for PE investment?**

**Executive summary**

Reasoning to analyze this type of dataset came with the interest in current events in car price market all over the world. At first it was an interest to see how much the car dealership companies were affected by price fluctuations and volatility in supply that car market has experienced over the last 3 years. Afterwards, it became interesting dig deeper to analyze who has been the best performing country in last 5 years and which country and specifically which company would possibly be the best company for Private Equity (PE) investment.

In recent years, there has been a big increase in car prices, due to short supply of semiconductors, they are an essential part of a car nowadays therefore cars can’t be produced without them. It seems like car companies are starting to struggle meeting the demand thereby creating a big time of uncertainty in the market. But how has this affected car dealerships? Are they still a good investment strategy in developing EU countries?

This report analyses a potential business scenario, where Private Equity firm wants to invest in car dealership company in developing part of Europe. This research focuses to analyze the best firms to invest in based on data available by platform “ORBIS” (2022).

The analysis concludes that Baltics are the best place currently for new investments in car dealership business. When looked in deeper, Latvia seems to be a really risky investment place with high uncertainty, while Estonia and Lithuania are looking much better. After that by looking at return on assets measurements for big firms it became clear that Lithuania is the best place to search for a firm to invest in. After further analysis in the firms, the company with the best return on assets ratio that didn’t have a big market share showed to be UAB Moller Auto. After some small assumptions it was concluded that the potential value of the deal to invest in this company could be 13 million EUR minus the expansion and investment costs the PE firm would occur.

**Project background**

Car dealership company sample was taken by collecting 2021-2017 data about firms that:

* Are an active company currently
* Have complete EBIT, Turnover, net income and employee amount data for last 5 years
* Companies that are stated to have primary NACE code connected to retail distribution of automotive transport.
* Companies that are registered in: Austria, France, Germany, Croatia, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia, Slovenia, Ukraine, Finland, Norway, Sweden.
* Companies, that average yearly turnover was over 100’000 EUR.

Together, information about 4434 companies were collected, with amount for each respective country can be seen in the dashboard.

To understand this report, there is a need to understand in a nutshell how PE company does business. In our project case, the report is presented to a PE company, that acquires already existing companies that they see a potential in. In maximum 5 years the company is transformed to be more efficient (improving operations) and grab a bigger market share. The latter is usually done with help of huge amounts of capital PE firms have. After companies’ valuation is increased, PE firm sells the company and keeps the profits it has gained from the difference between selling price and acquisition price.

**Analysis**

**Industry**

Firstly, the companies are grouped in 4 groups:

1. Nordics – Norway, Sweden and Finland
2. Baltics – Estonia, Latvia and Lithuania
3. Developing region – Ukraine, Romania, Poland, Hungary, Croatia, Slovenia and Slovakia
4. Developed countries – Czech Republic, France, Germany and Austria

Observing the results, output can be best observed from this chart:

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*Image 1. Return VS Profit average for EU regions. (Bubble size – average turnover)*

Looking at the graph clearly shows the picture that on average, firms from developed region and Nordics have a clear lead in revenue over Baltics and developing region. But most interestingly, there is one more connection that seems even more crucial. The relationship that can be observed from Revenue VS Profit per employee. It can be observed that Nordic companies on average are far superior to rest of the EU region in operational efficiency, because their profit per revenue gained is much larger than any other region. This is where potential value is observed for PE company – if a company could come in the region and increase companies’ efficiency and profitability, the company’s valuation would be increased. Image 1 creates an impression that, investment in developed region would make most sense, because of high upside potential, but these countries are not as keen to foreign investment and ownership. Additionally, to that, most of car producers are from developed region in EU, therefore there are more direct factory dealerships. This would mean that potentially dealerships are not as interested in profits, since that is only a subsidy of a bigger car producer. This is why going in developed market could be considered to be too risky, since a normal dealership can’t compete with direct manufacturers dealerships.

Additionally, there is no point in going in Nordics market, because the efficiency is already reached, and PE company would have close to no changes it could potentially do to increase companies value.

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*Image 2. Median yearly EBIT (Earnings before interest and tax) growth for each region.*

Additionally, observing data in Image 2, an image can be seen that indicates, while developing countries experienced a higher growth before COVID-19 pandemic, after 2020, trends have shifted, and EBIT growth is actually more prominent in Baltics sector.

Furthermore, it can be observed that in 2020 EBIT decrease form the pandemic was the softest in Baltics, if we don’t consider Nordic countries in the comparison.

Since developing countries seem to be more unpredictable, worse performing and revenue per employee being slower, it can be concluded that Baltic region is the best region PE firm should focus on.

**Countries**

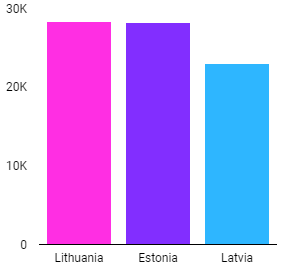
Private equity company on average can change 2 major things: funding for the company and change the company structure to make the business more profitable with the experience and expertise PE funds operate with.

To see is capital actually has any effect in our observed countries, OLS regression was created (Appendix 1) where effect of capital on turnover was observed through looking at total assets’ relationship with turnover. The results presented a big positive effect in increasing total assets, therefore first metric that needs observing in country scale is return per asset efficiency. The better the efficiency, the better the country can allocate its assets.

Second metric that the analysis focuses on is return per employee, which indicates the revenue per employee the company is getting.

While this metric is also very important, it shouldn’t have the most say in a decision, because return per employee is also an operation that can be optimized, while return per assets could be influenced by tax structure of the company, or just an overall potential return on capital, for example, rent could be cheaper in Lithuania then Estonia, therefore return on assets are better in that region and cant be changed as easily and should be looked as the main variable.

Before taking a look previously mentioned metrics, it is important to look at financial data divided by population of the country. Fully they can be looked at in the dashboard at the bottom of second page. All of these measure outputs indicate, that when any metric is divided by Capita, Latvia is seriously falling back behind Lithuania and Estonia. This result is partly influenced by Latvia having worse purchasing power than rest of Baltic countries (Image 3) , which is 5 thousand EUR lower than the rest of Baltic countries. (Eurostat, 2022) Despite that, the measures presented seem to be much lower than this gap only would suggest, meaning that in Latvia the profits are more distributed among more firms leading to more competition.



*Image 3. Purchasing power of Baltic countries.*

Latvia definitely proposes a big opportunity for a company to become a market leader and with a big upside if the lack if the metrics could be increased by , at the same time introducing a high risk to PE company of Latvian citizens not being able to meet the market expectations. Therefore, if PE firm is really risk tolerant, Latvia should be examined further, but in this case, author considers Latvia to be too risky investment, therefore the focus should be only on Estonia and Lithuania.

Looking at the rest of the data, the conclusion of best country seems to be contradicting. Lithuania is better in return per assets part, but Estonia is better in revenue and profit pre-employee metrics. While it is already mentioned that return on assets is the most important value for company analysis both countries will be observed.

**Firms**

To deep dive into firm analysis and understand the best firm to invest into, multiple pints were considered, but majority focus was put on return vs profit per employee relationship as well as performance measures with the main focus being on return on assets.

Only top 5 turnover making firms in each country were compared for observation, because:

* There are bigger firms usually have the most reliable data available
* Performance ratios can be very good, but actual business sales almost non existing, therefore Top 5 was calculated from a 5-year average: output shows already established firms that have maintained a normal cash flow throughout all 5 years.
* Already well-established relationship with a supplier.
* PE companies usually look at companies that have a good business, they are not interested in small businesses and startups.

Afterwards, the firms were evaluated as not to have too big of a market share, because if the firm is already a market leader, it has lower market value increase potential.

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*Image 4. Return on assets comparison between Estonia and Lithuania*

When comparing return on assets measure in Lithuania and Estonia for top 5 companies (Image 4), it becomes much clearer that Lithuanian companies are a much better place for PE company to invest in, since in Lithuania top firms are much more efficient with its capital usage efficiency. Therefore, the best firm for investment will be searched in Lithuania.

Already by observing Lithuanian companies in image 4, it can be observed that UAB AUTOBRAVA is a clear leader in capital allocation. Unfortunately, the firm already is a market leader in Lithuania, with almost 20% share of market in Lithuania.

Next comes UAB Baltijos Autonoma, that has a huge margin, but again fails at a point that it already owns 13% of Lithuanian car dealership market share.

Third on the list is the firm: **UAB Moller Auto**. Return on assets are higher than any form in Estonia, and the firm has only 5% market share. When looked at return vs profit graph, both profit and return per employee values seem to be low, but turnover seems to be at the same level as other firms that were mentioned before meaning that with more efficient operations, possible restructuring and expanding with capital and operations this firm could easily increase its valuation.

As a last check actual products of companies were observed. AUTOBRAVA which is the best performer all around is selling Mercedes cars, while Moller auto sells Volkswagen and Audi brands. While Mercedes can obviously have a bigger profit margin, Audi and Volkswagen are still very respectable brands meaning that Moller auto can easily reach a turnover and profit levels of AUTOBRAVA.

If the company reaches AUTOBRAVA levels, turnover would be almost doubled. Meaning turnover increase by 70 million, while enterprise valuation would increase by 13 million. This enterprise valuation minus the investment costs would be the profit the PE firm could have.

**Conclusion**

From the above-mentioned analysis, it can be concluded that Lithuania has the best performing firms for capital rich PR firm to acquire. More specifically – UAB Moller Auto is the one that stands out as the best option, based on best performance of return on assets measure, as well as the company not being a market leader already. All this points to huge potential growth in the future. With a simple calculation done in analysis part, it can be assumed that if PE firm would be able to increase the business to the same level as UAB Autobrava, this deal could be worth about 13 million Euro, minus the investment that would be put into the firm.

Estonia was a close second, but in comparison with Lithuania lack efficiency on their asset allocation. At the same time, their average return per employee is bigger than Lithuania, therefore if a firm is more interested in employee performance in the get go, then this country is a good option as well.

In the last place there is Latvia, that didn’t stand out in any performance metric, as well as achieved significantly lower levels on company financial data, when those data were divided by population numbers. Therefore, Latvia can be looked at as a gamble. The country could have big upside potential, if one firm could achieve a big market share and incredibly boost a company’s efficiency. On the other hand, the poor average performance could be an indicator of harsher market conditions, where it is harder to get extra demand. Therefore, PE company is risk averse, then also Latvia could be a good option and further investigation would be necessary.

**Recommendations**

For PE firms, the conclusion for the best company could differ, based on the company’s experience, risk tolerance and preferred analysis measures. To recommend some concrete strategy would be relatively hard because the analysis is only done from yearly data. If a PE would fully want to invest, it would need to approach potential client (In this case: UAB Moller Auto), ask it to sign an NDA and later dig into the company’s financials at an even deeper level. The recommendation would be for PE managers to observe the created dashboard and after reading this paper, understand if their assumptions align with what Is written here. If the assumptions are similar: UAB Moller Auto is the best company with the best future potential.

***Appendix***

*Appendix 1, Regression for effects on turnover*

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