Vehicle Service Contract Industry

Strong Market Fundamentals:
Growth and Investor Interest Continue

The vehicle service contract (VSC) industry continues to attract significant interest among investors and consolidators. Macro fundamentals are compelling, and the industry demonstrates growth, strong margins and recurring cash flow. The industry value chain includes administrators, F&I agencies, direct-to-consumer marketers, payment plan providers and specialty insurance carriers. In 2018, the industry was $35 billion at retail with significant opportunity for growth; there were 132 million vehicles that did not have a VSC but were eligible. Since 2010, more than 60 companies in the VSC industry have changed ownership. We expect sellers to continue to benefit from strong demand among financial investors and strategic buyers for well-run businesses in the sector. New entrants and consolidators should enjoy industry tailwinds for several years.

The VSC industry is benefitting from compelling macro trends:

- The attachment rate of VSCs on new cars sales continues to increase.
- Used cars sales continue to be strong. These vehicles typically outlive their OEM warranties and have higher maintenance needs, creating demand among consumers that are increasingly accustomed to buying vehicle protection products.
- We estimate the market size of the "sweet spot" for post-OEM warranty VSC sales will continue to grow to 109 million vehicles by 2024 from an estimated 87 million vehicles in 2018.
- Consumer demand for VSCs is significant: an estimated 40% of Americans do not have cash on hand to pay for an emergency expense of $400 or more. As the average age of vehicles increases and drivers hold their cars longer, the need for protection plans is increasing.
- Dealership margins remain under pressure, and F&I products provide significant profitability.
- However, there has been increased risk for individual F&I products companies due to dealership consolidation.

The pace of acquisitions and investments in the VSC industry is increasing, driven by demand from financial and strategic investors and the availability of capital. Private equity firms are attracted to the industry for its high margins, strong cash flow, fragmentation and growth. There are several trends in the current M&A activity in the VSC industry, including the acquisition of administrators with a strong book of house accounts, companies with a specialty in captive reinsurance, diversified F&I agencies and companies that address the largest opportunity: vehicle owners after they buy their car.

Private equity firms are buying platform companies and making add-on acquisitions to existing portfolio companies. More and more, industry participants are considering vertically integrating, potentially disrupting market dynamics among the pure plays. We expect strong demand for well-run companies in this industry to continue.

F&I Products Ecosystem

There are multiple segments in the VSC industry and companies use varied business models.

F&I PRODUCTS ECOSYSTEM

M&A UPDATE

The pace of acquisitions and investment in the F&I products industry is increasing. Activity is driven by positive macro trends, private equity interest in the industry and the need for strategic buyers to accelerate growth and improve scale. Industry participants are vertically integrating to lock-in or increase distribution, enhance revenue and margins and increase scale.

Investments and Acquisitions by Private Equity Firms

Private equity firms are attracted to the industry by the high margins, strong cash flow, fragmentation, and growth of the industry.

Platform Acquisitions: Private equity firms generally seek platform acquisitions of companies that can grow both organically and through bolt-on acquisitions. A recent example is Crestview Partners' acquisition of Protect My Car, a vertically integrated seller, administrator and payment plan provider.

Add-on Acquisitions: Many private equity-backed F&I companies are seeking acquisitions to diversify products, increase scale, vertically integrate to capture more of the value chain and enhance distribution channels. Recent examples include Endurance's (administrator) acquisition of AutoAssure (direct-to-consumer marketer), Portfolio Group's (administrator) acquisition of Finance Concepts (F&I agency), and IAS's (administrator) acquisition of Kingstar (direct-to-consumer marketer and payment plan company).

Acquisitions by Administrators

Administrators are seeking to grow the top line, improve margins and lock-in distribution.

- Administrators, the majority of which do not have a significant direct sales force, are challenged to grow organically because they do not control the distribution of their products. These administrators are dependent on F&I agents and direct-to-consumer marketers, both of which sell the products of multiple administrators. The acquisition of an F&I agency or a direct-to-consumer marketer can accelerate growth and lock-in distribution.
- Administrators are seeking margin improvement through scale and by capturing more of the value chain through vertical integration. A recent example is Protective's (administrator) acquisition of U.S. Warranty (administrator).

Acquisitions by Insurers and Insurance Agencies

Insurance companies that are already in the F&I products industry have been making acquisitions in the sector. Insurers that underwrite VSCs are acquiring administrators in order to capture or preserve books of business while new entrants are evaluating administrators as a logical product extension of specialty insurance lines. Traditional insurance agencies are adding F&I agencies to expand product offerings. Recent examples include Brown & Brown’s acquisitions of F&I Resources (F&I agency) and Automotive Development Group (F&I agency), and iA Financial Group’s (VSC) acquisition of Southwest Re (administrator).

DATE	TARGET	BUYER/INVESTOR	SUB-SECTOR
Sep-18	F&I Resources	Brown & Brown	F&I Agency
Sep-18	**Protect My Car**	Crestview Partners	DTC Marketer and Administrator
Jul-18	National Auto Care	Lovell Minnick Partners	Administrator
May-18	Automotive Development Group	Brown & Brown	F&I Agency
Oct-17	AmTrust – Fee Based Business	Madison Dearborn Partners	Administrator
Oct-17	The Warranty Group	Assurant	Administrator
Sep-17	DAC/Southwest Re	iA Financial Group	Administrator and Insurer
Sep-17	ForeverCar	Investor Group	DTC Marketer
Aug-17	Evergreen Dealer & Insurance Services	SouthWest Dealer Services	F&I Agency
Jul-17	Automotive Assurance Group	AmTrust	F&I Agency
Jun-17	Finance Concepts	Portfolio Group (*Capital Z*)	F&I Agency
May-17	**Mepco**	Seabury Asset Management	Finance
May-17	KingStar	IAS (*Genstar*)	DTC Marketer and Finance
Apr-17	Omnisure and PayLink merger	PayLink (*Milestone*), Ominsure (*Fortress*)	Finance
Dec-16	NitroFill	Kinderhook Industries	Administrator
Aug-16	**AutoAssure**	Endurance Dealer Services (*TRP*)	DTC Marketer
Aug-16	United States Warranty Corp.	Protective	Administrator
Jul-16	National Truck Protection	Kinderhook Industries	Administrator
Jun-16	Expresslink/Cartel	Confie Seguros (*Abry Partners*)	F&I Agency
Jun-16	The Portfolio Group	**Capital Z**	Administrator
Apr-16	United Insurance Group and Olympic Dealer Marketing	SouthWest Dealer Services (*Spencer Capital*)	F&I Agency
Feb-16	**Automotive Development Group**	APCO (*Ontario Teacher's Pension*)	F&I Agency
Jan-16	APCO	Ontario Teachers' Pension Plan	Administrator
Jun-15	**Endurance Dealer Services**	TRP	Administrator and Marketer

Bold Indicates Colonnade Client

ACQUISITION TRENDS

Acquisition Trend: Administrators with a Strong Book of House Accounts

F&I agents largely control the distribution of products into dealerships and most administrators are dependent on this network. Administrators that have direct relationships with dealerships that bypass the independent agents ("house accounts") are more valuable because they are not dependent on a third-party for distribution. These house account relationships are typically at the dealer-owner level and are generally quite persistent. We see administrators looking to bypass third party relationships by acquiring agencies.

Acquisition Trend: Administrators and F&I Agents with a Specialty in Captive Reinsurance Solutions

Dealer reinsurance programs are maintained at the dealership-owner level rather than at the F&I office level. These relationships are sticky as reinsurance is often a wealth management tool for dealership owners. Companies that have the capability to structure captive reinsurance solutions have a competitive advantage as it is difficult for other administrators and agents to unseat the incumbent.

Acquisition Trend: F&I Agencies with Enterprise Value, Diversified Clients and Long-Term Relationships

The most valuable agencies are those with diversified dealership clients and long-term relationships. Diversification is important as M&A activity among dealerships has accelerated (see Threat: Consolidation of Dealerships). We see strong investor interest in the F&I agency sector given its low capital intensity and high recurring revenue characteristics.

Acquisition Trend: Companies that Address Owners After the Purchase of the Vehicle

The largest market opportunity for the sale of VSCs is after the vehicle purchaser leaves the dealership. As dealerships and OEMs struggle to increase profitability, they are focusing on the "missed opportunities," the 55% of vehicle buyers, representing 9.5 million vehicles in 2018, who did not acquire a VSC at point of sale. There are few companies that address this market segment. Other companies address the 87 million vehicles that are post-OEM warranty by marketing directly to consumers online and through direct mail.

There have been some deals in this segment including:

- Crestview's acquisition Protect My Car, a direct-to-consumer marketer and administrator of VSCs and
- TRP's acquisition of Endurance Vehicle Services, a direct-to-consumer marketer and administrator of VSCs

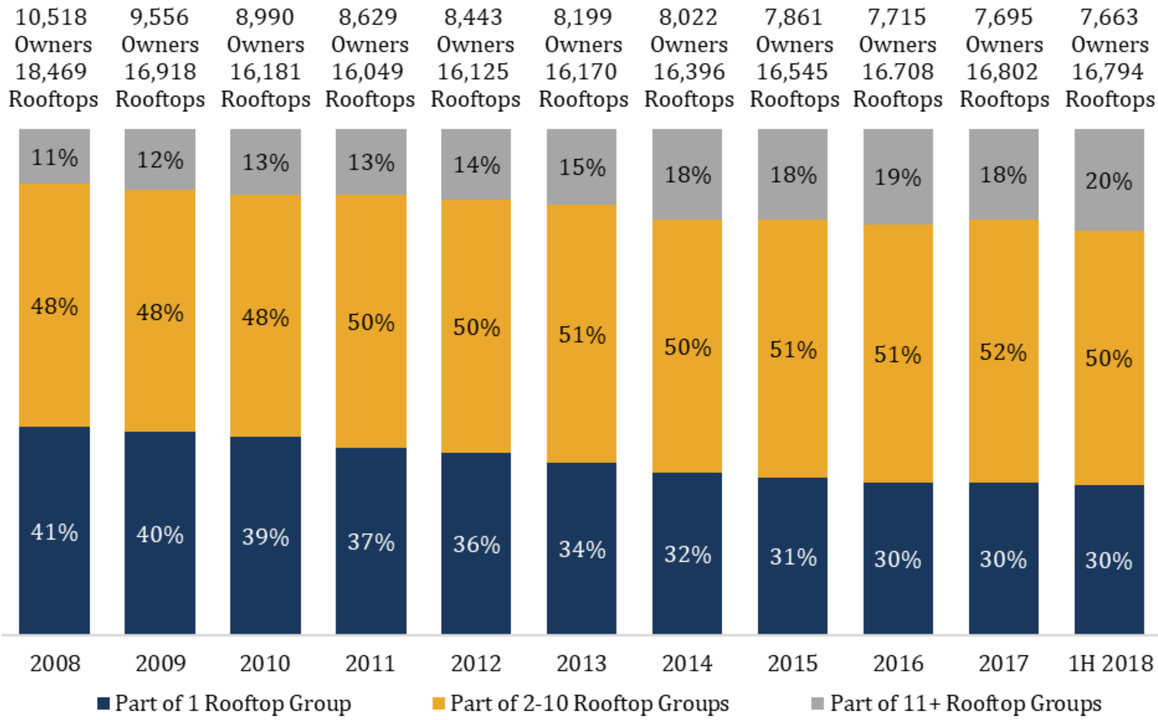
We expect more interest in acquiring companies that address the post-OEM warranty vehicles, as it is the largest market opportunity.

THREAT: CONSOLIDATION OF DEALERSHIPS

The most significant challenge to administrators and F&I agents is dealership consolidation. Dealership mergers and acquisitions are at a record level, with transaction volume increasing 20% in 2018 over 2017. Over 1,500 dealerships have been sold since 2012. Additionally, the big keep getting bigger, as the top 50 dealers were estimated to have booked more than $175 billion in revenue in 2018 compared to $144 billion in 2014.

Dealership consolidation poses a significant threat to administrator and F&I agents' books of business. The F&I relationship is often at the owner level, and with 2,855 fewer owners than in 2008, the universe of relationships is getting smaller. The number of times at bat is diminishing as there are 1,675 fewer rooftops than in 2008. As dealerships change hands, the buyer is likely to eliminate duplicative products, move the acquired dealerships to its existing administrator and F&I agency relationships and potentially squeeze margins for the F&I provider. Agents and administrators with more than 15% of revenues from a single dealership group can experience significant volatility in earnings when one of its dealership clients is sold. Customer concentration can negatively impact valuation in a sale transaction.

DEALERSHIP CONSOLIDATION



Source: NADA

CONCLUSION

We anticipate further merger and acquisition activity over the next few years as:

- Industry fundamentals remain strong. The market is growing due to increased consumer demand,
- Entrepreneurs decide to exit or achieve liquidity in a strong market,
- Private equity firms seek to harvest the value of their VSC investments, and
- Companies consolidate to benefit from enhanced customer relationships, diversification and expense synergies.

Colonnade has advised on sixteen M&A and financing transactions in the F&I industry and maintains relationships with owners and operators across the various segments as well as investors seeking to enter. If you are a business owner and would like to discuss valuation and strategic alternatives, please email or call us directly.

Email us to meet at NADA in San Francisco in January, LeadsCon in Las Vegas in March or Agent Summit in Las Vegas in May 2019.

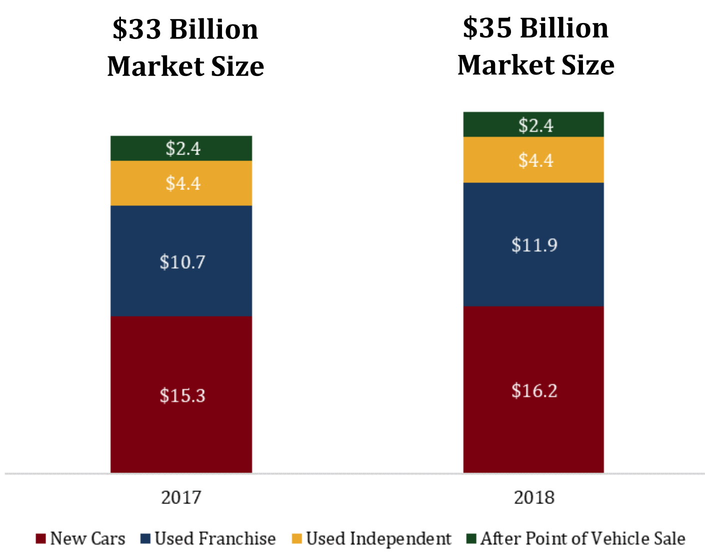
Appendix

Strong Macro Trends are Driving Acquisitions and Investments in the VSC Industry

U.S. consumers spent an estimated $35 billion on VSCs in 2018. VSCs are typically marketed at three points in the life cycle of an automobile: (i) at original sale (the new vehicle segment – extended warranties), (ii) near or after expiration of factory warranty primarily via direct-to-consumer sales (the end-of-warranty segment) and (iii) at resale (the used vehicle segment). The VSC market benefits from high new and used car sales and increasing penetration rates. Consumers value VSCs as they have limited funds to pay for repair bills and they are owning vehicles longer. Dealerships focus on VSC sales to enhance margins. F&I products provide increasing incremental profitability and represent 25% of total dealership gross profit, compared to 15% in 2009. We expect these dynamics to continue.

The VSC market size has grown by 6.9% to $35 billion since Colonnade's last whitepaper in August 2017. The growth is attributed to three trends: 1) the increase in attachment rates on new vehicle sales, 2) the increase in used car sales and 3) the increase in vehicles out of the OEM warranty period.

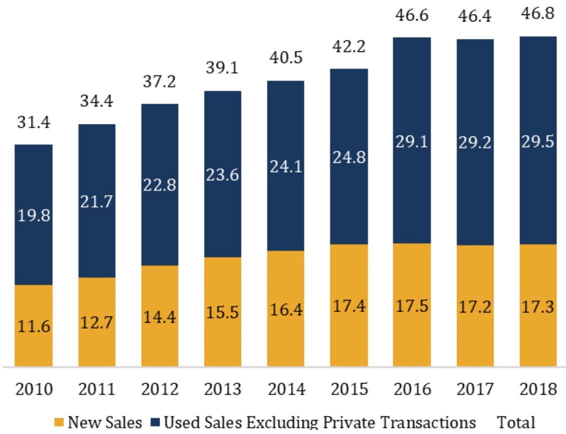
RETAIL MARKET FOR VSCS IN 2018 COMPARED TO 2017



Source: Colonnade estimates

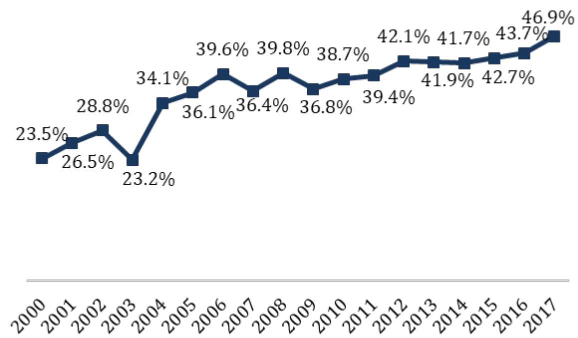
New cars sales ultimately drive sales in the VSC market. New car sales were 17.3 million units in 2018, a slight increase from 2017. However, VSC attachment rates, or the percent of new vehicles sold with a VSC, have increased significantly in the last year causing the new vehicle VSC market size to increase by 5.9% to $16.2 billion.

VEHICLES SOLD THROUGH DEALERSHIPS *(units in millions)*



Sources: NIADA, Manheim Used Car Reports and Colonnade estimates

NEW VEHICLE VSC ATTACHMENT RATE

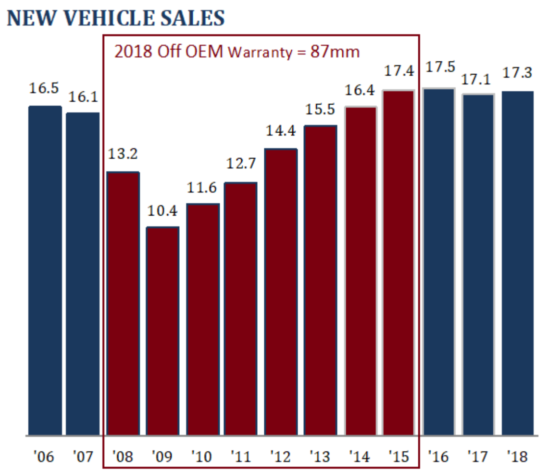


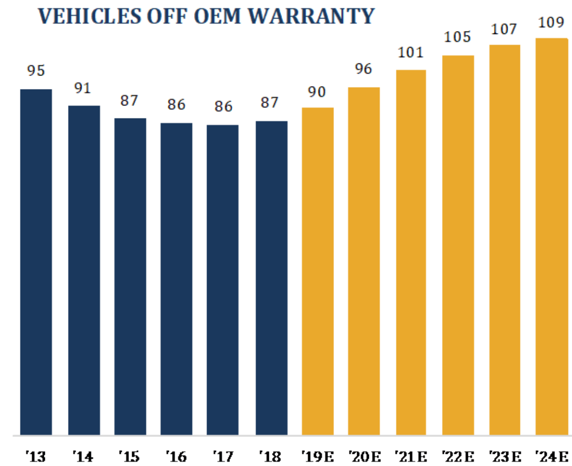
Sources: NADA & Baker Tilly Automotive Benchmark Survey

Used vehicle sales are at an all-time high level and are driving the purchase of VSCs. Older vehicles have typically outlived OEM warranties and have higher maintenance needs, factors that have a positive impact on consumer demand for VSCs. There has been an influx of late-model off-lease vehicles returning to dealers which are older, higher mileage and outside of the manufactures warranty, thereby increasing the need for VSCs on used vehicle sales. Colonnade estimates that 42% of used vehicle sales through franchise dealerships and 20% of used vehicle sales through independent dealerships have a VSC attached. The estimated franchise attachment rate increased from prior Colonnade analyses based on surveys completed by Baker Tilly and NIADA.

The number of vehicles post-OEM warranty has increased to an estimated 87 million vehicles from 86 million in 2017. These vehicles were post OEM warranty and less than twelve years in service, the "sweet spot" for aftermarket VSCs. Year 2017 represents the fewest vehicles in the sweet spot in the last seven years, as a result of the low number of new vehicle sales during the recession. Our research indicates that longer vehicle life coupled with continued high levels of new car sales post-recession will generate a continued growing market for post-OEM sales of VSCs.

INCREASING NUMBER OF VEHICLES OFF OEM WARRANTY (*units in millions*)

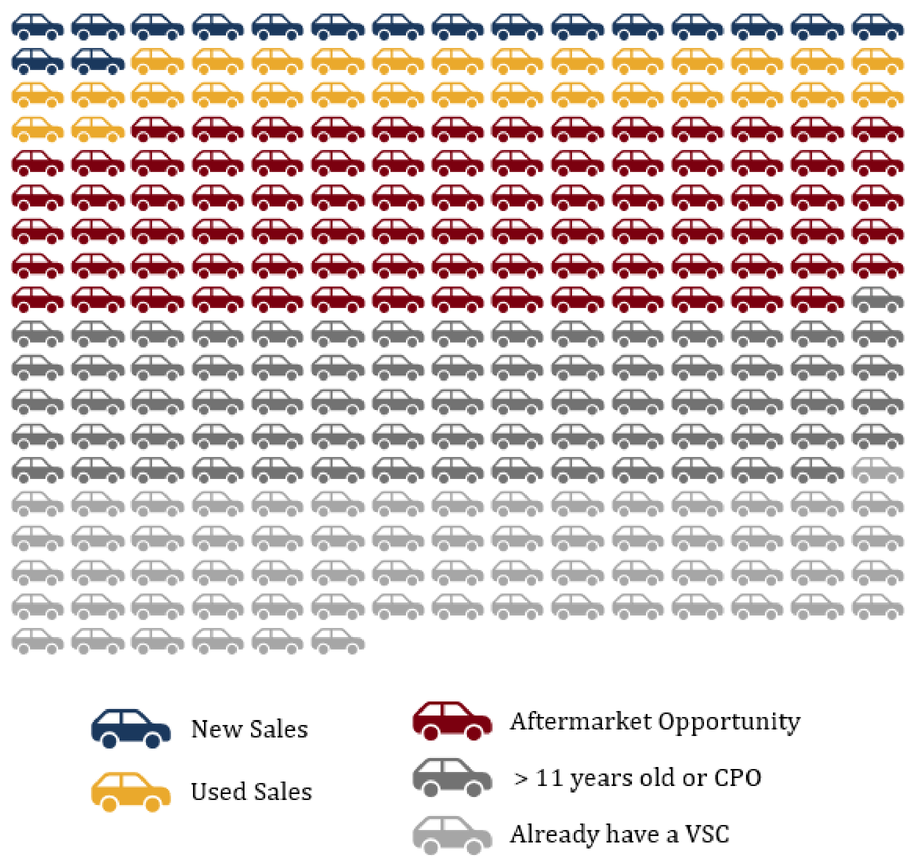




Source: NADA, Experian, and Colonnade estimates

Of the 276 million vehicles on the road, 48% are eligible for a VSC. This group includes new vehicle sales, used vehicle sales and post-OEM warranty vehicles that are less than twelve years old.

VEHICLES ON THE ROAD IN 2018 (*each car represents one million vehicles*)



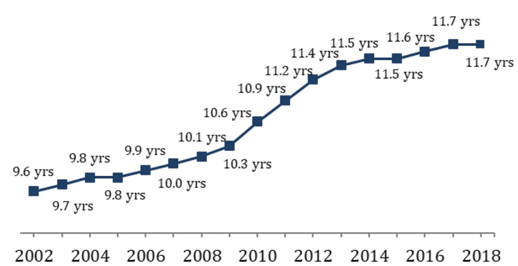
Source: Colonnade estimate

Increasing Consumer Demand for VSCs

Consumer demand for VSCs is increasing as the vehicles on the road are older and higher mileage vehicles have heightened maintenance needs. U.S. consumers are holding on to their cars for longer than ever, partially due to the higher quality of vehicles.

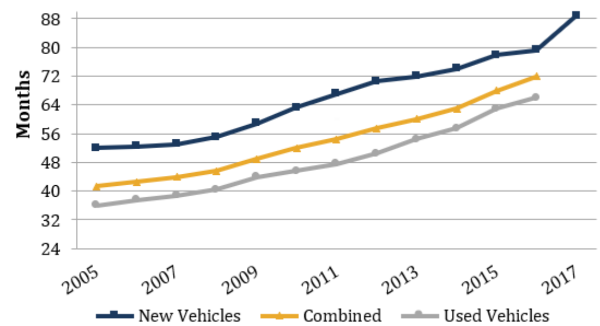
The average age of passenger vehicles on the road was 11.7 years at the end of 2017, up from 9.6 years in 2002. One of the reasons for the increase was the 40% drop in new vehicle sales in 2008 and 2009. The record number of new vehicles purchased in 2015 and 2016 will slow the rate of increase, resulting in an average estimated age of 11.8 years in 2020, according to IHS Automotive.

AVERAGE AGE OF PASSENGER VEHICLES



Source: IHS Automotive

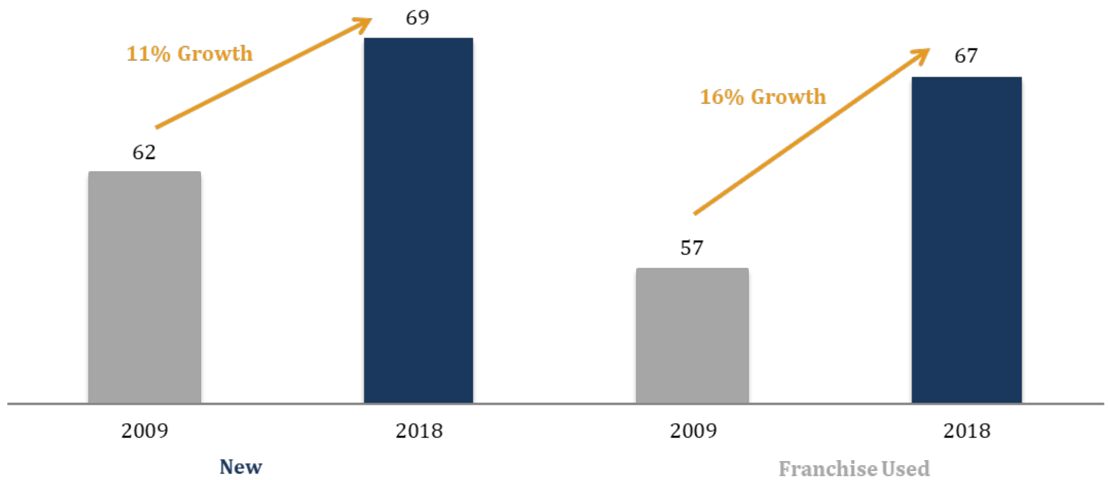
LENGTH OF VEHICLE OWNERSHIP



Source: Estimated from IHS Automotive, Colonnade

Vehicle owners are increasing their length of ownership. New vehicle buyers now own their vehicle for 6.6 years compared to an average of 4.3 years in 2006, according to IHS Automotive. Used vehicle buyers now own their vehicles for 5.5 years compared to an average of 3.3 years in 2006. This trend is due to longer loan terms and the higher quality of vehicles. By using longer-term loans, consumers can reduce monthly payments and afford more expensive vehicles. Over 85% of new vehicle and 53% of used vehicle purchases are financed, and six to ten-year loans are becoming more popular. As a result of the extended terms, borrowers are not in a net equity position until their fourth year and frequently beyond the manufacturer's warranty. To increase a borrower's ability to pay on loans, lenders include the value of F&I products in loan-to-value calculations as a borrower is more likely to stay current on a functioning car. These trends create the opportunity for higher VSC penetration.

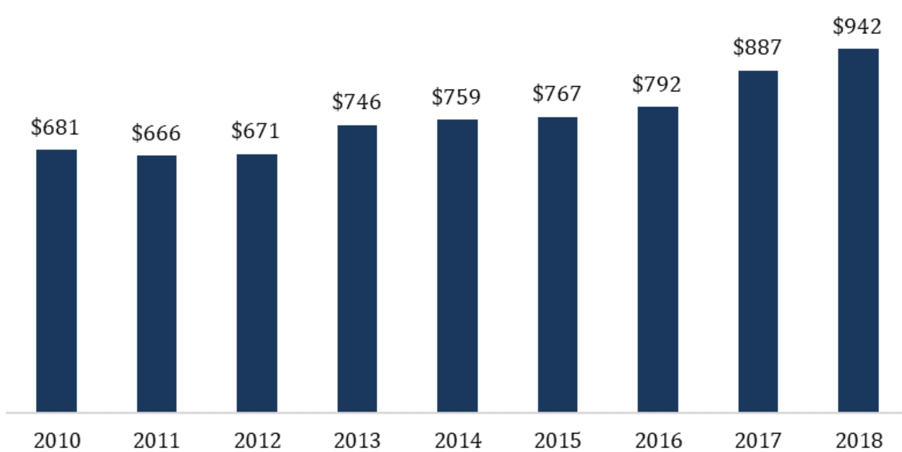
AVERAGE LOAN TERMS (*months*)



Source: Experian

The increasing number of older cars is creating more vehicles that need repairs and maintenance; repairs generally become more expensive as vehicles age. Many consumers are unable to afford repairs as the growth in costs is outpacing wage growth and 40% of Americans do not have $400 in emergency funds. These trends are driving demand for VSCs.

AVERAGE VEHICLE MAINTENANCE AND REPAIR COSTS (*dollars in actual*)

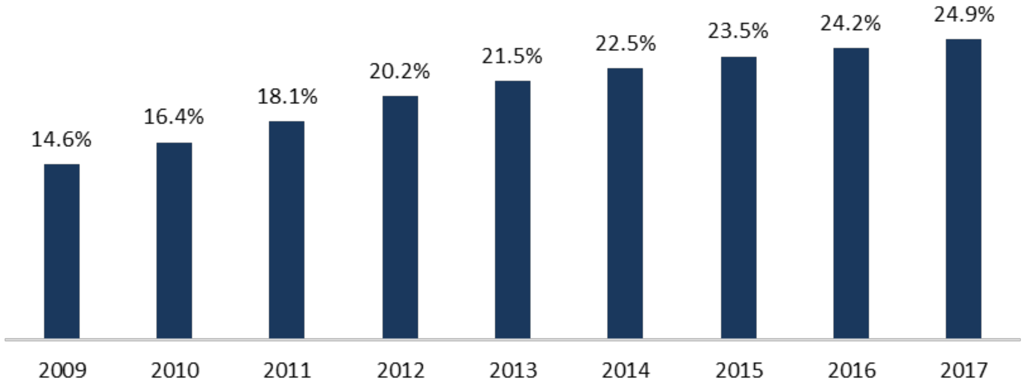


Source: AAA "Your Driving Costs Study", based on 15,000 miles driven in a year

F&I Focus at Dealerships

Despite improved auto sales, dealership margins remain under pressure, and F&I products provide meaningful incremental profitability. Dealerships have become more dependent on F&I products, as they represent 25% of total dealership gross profit compared to 15% in 2009. This trend will continue as dealership margins on vehicle sales may be squeezed in coming years. In addition to increasing vehicle sales margins, F&I products improve long-term profitability by enhancing customer loyalty and retention by setting the stage for repairs, routine servicing sales and subsequent car purchases at the dealership.

F&I DEPARTMENT CONTRIBUTION TO DEALERSHIP GROSS PROFIT



Source: NADA

Growth in the number of older vehicles is a positive trend for aftermarket repairs. However, dealerships will face strong competition for these increased repair revenues. Longer periods of ownership take consumers farther away from the selling dealership service lane to less expensive non-dealership repair facilities. Dealers seek to counter this trend by selling VSCs and prepaid maintenance plans to increase the likelihood of drivers returning to the dealerships.

COLONNADE IS THE LEADING FINANCIAL ADVISOR TO THE F&I PRODUCTS INDUSTRY

PMC PROTECT MY CAR
has been acquired by
Crestview
Crestview Partners
The undersigned acted as exclusive financial advisor to Protect My Car
Colonnade Securities LLC

APC Integrated Services Group, Inc.
has been acquired by
SOUTHFIELD
and management
Colonnade acted as exclusive financial advisor to APC Integrated Services Group, Inc.
Colonnade Securities LLC

ENDURANCE
has been sold to
TRANSPORTATION resource partners
Colonnade acted as exclusive financial advisor to Endurance Warranty Services, LLC and Endurance Dealer Services, LLC
Colonnade Securities LLC

CAPITAL Z PARTNERS
has acquired
Portfolio
Colonnade acted as financial advisor to Capital Z Partners Management, LLC
Colonnade Securities LLC

SOUTHFIELD
has acquired with management
VANGUARD DEALER SERVICES
Colonnade acted as financial advisor to Southfield Capital
Colonnade Securities LLC

HMC HARBERT MANAGEMENT CORPORATION *and* NORTHSTAR CAPITAL LLC
have sold
PREFERRED WARRANTIES INC. *to* KAR AUCTION SERVICES
The undersigned acted as exclusive financial advisor to Harbert Management Corporation, Northstar Capital LLC and mangement of Preferred Warranites Inc.
Colonnade Securities LLC

ADG AUTOMOTIVE Development Group
has been sold to
APCO HOLDINGS, LLC
Colonnade acted as exclusive financial advisor to Automotive Development Group, LLC and The Zabel Companies
Colonnade Securities LLC

INDEPENDENT BANK
has sold
MEPCO finance corporation
to
Seabury Asset Management LLC
The undersigned acted as exclusive financial advisor to Mepco Finance Corporation
Colonnade Securities LLC

AutoAssure Extended Repair Coverage
has been sold to
ENDURANCE
TRP Capital Partners
The undersigned acted as exclusive financial advisor to AutoAssure, LLC
Colonnade Securities LLC

OMNISURE
has been sold to an investment group led by management and
Fortress Investment Group LLC
(NYSE: FIG)
The undersigned acted as exclusive financial advisor to Omnisure Group, Lincoln Park Capital and Management
Colonnade Securities LLC

D E Shaw & Co
has sold
PayLink Payment Plans LLC
to an investment group led by
OXFORD FINANCIAL GROUP, LTD
Colonnade acted as exclusive financial advisor to D.E. Shaw and Paylink Payment Plans
Colonnade Securities LLC

MEPCO insurance premium financing
has been acquired by
Independent Bank Corporation
(NASDAQ: IBCP)
The undersigned acted as exclusive financial advisor to Mepco Insurance Premium Financing, Inc.
Colonnade Securities LLC

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