

VALUE FOCUS

Auto Dealer Industry



Mid-Year 2014

Overview

The aptly named Great Recession hit the auto industry and its dealers harder than almost any other industry, save for construction and housing: As unemployment rose, consumer spending and home values plummeted. With little to no discretionary income and no means to finance car purchases, sales tumbled, margins were squeezed, and GM and Chrysler filed for Chapter 11 bankruptcy. Recovery began in 2009, confidence and disposable incomes rose allowing consumers to fund purchases of more durable goods, including cars. These trends are expected to continue through 2019. However, the auto dealer industry, though making a strong recovery from the most recent recession, is facing pressures from government regulation, shifting demand and supply, and new market entrants.

More stringent environmental standards and rising oil prices are causing car prices to rise, the shift to internet for information and purchasing is forcing margins down (but also increasing volume), and demand is shifting more toward hybrid, electric, and autonomous cars. The leading auto dealers are taking notice of these shifting trends. In June, Mike Jackson, CEO of AutoNation, stated that by the end of the year, “customers [via the company’s website] can select specific vehicles, get a committed price, give us a deposit, and that becomes their vehicle without ever having entered the store. If somebody walks in 10 minutes later and wants to buy that vehicle, no, it’s committed to that digital transaction.” All things considered, revenue for new cars is expected to grow at 2.0% per year through 2019, though margins will unlikely keep pace.

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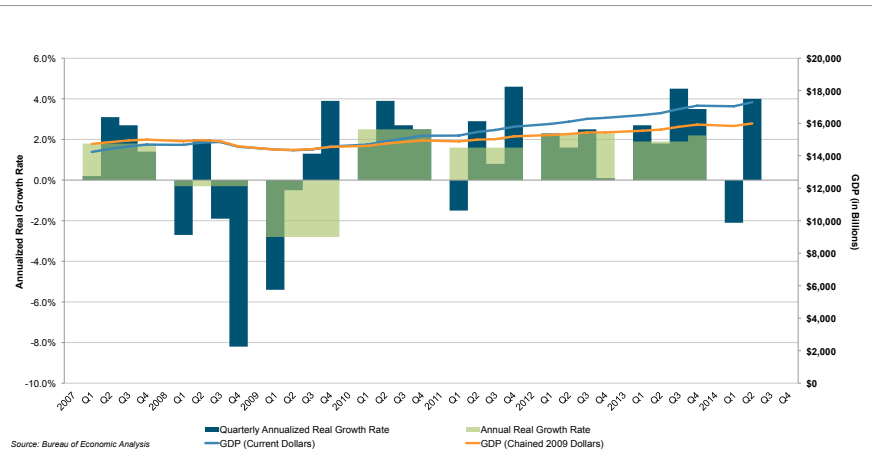
Macroeconomic Indicators // Productivity

Rising disposable income, a measure of consumers' ability to support debt-funded purchases, is dependent on an economy's productivity. While the Great Recession reached its official end in mid-2009, economic growth remains somewhat subdued, as does growth for durable goods. Unemployment remains elevated and labor force participation remains low. Economic growth is expected to remain positive, though government spending cuts, political uncertainty, and rising interest rates are causes for concern. GDP growth expectations from private economists surveyed by *The Wall Street Journal* are on the order of 3.1% for the third quarter of 2014 and 1.6% for all of 2014. This compares to GDP growth of 1.8%, 2.8%, and 1.9% in 2011, 2012, and 2013, respectively.

GDP

According to estimates released by the Department of Commerce's Bureau of Economic Analysis, Real Gross Domestic Product ("GDP"), the output of goods and services produced by labor and property located in the United States, increased at an annualized rate of 4.0% during the second quarter of 2014. The increase in real GDP during the second quarter was attributable to personal consumption expenditures, private inventory investment, exports, nonresidential fixed investment, state and local government spending, and residential fixed investment.

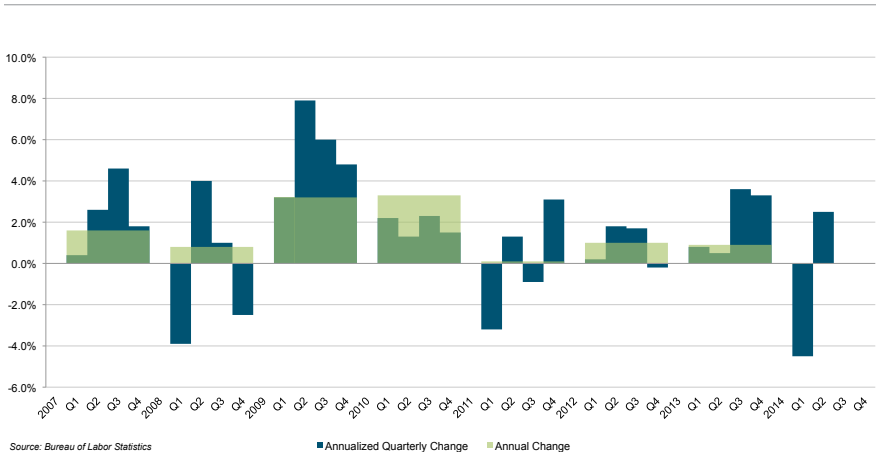
Gross Domestic Product



Nonfarm Business Productivity

According to the Bureau of Labor Statistics, seasonally adjusted nonfarm business productivity, as measured by the hourly output of all persons, increased at an annual rate of 2.5% in the second quarter of 2014. The productivity increase was a function of the 5.2% increase in output exceeding the 2.7% increase in hours worked.

Change in Nonfarm Business Productivity

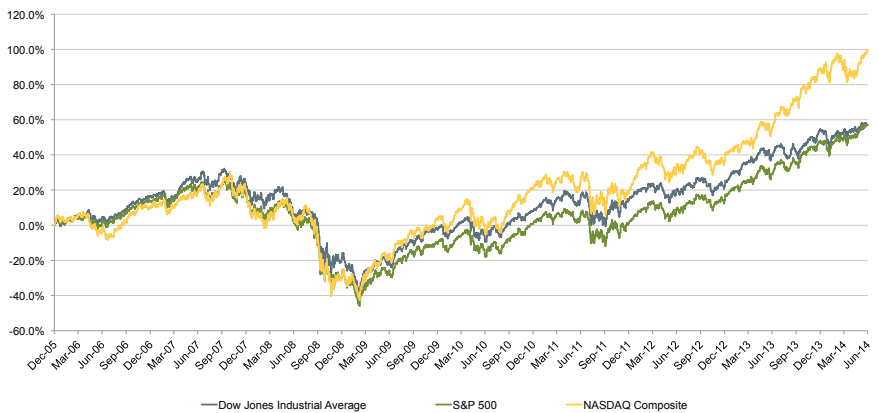


Macroeconomic Indicators // Productivity (cont.)

Equity Indices

Broad market equity indices exhibited generally upward performance in the second quarter of 2014. The S&P 500 and the NASDAQ both posted six consecutive quarters of gains, a trend not seen since 2000. The Dow Jones has recorded five quarters with gains out of the last six.

Equity Index Price Return

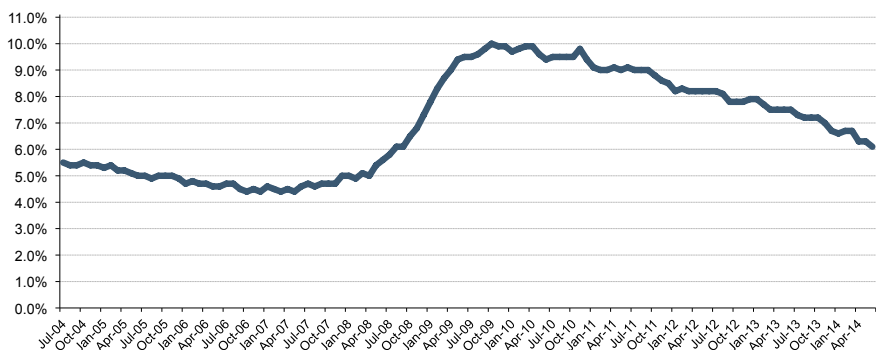


Source: Bloomberg L.P.

Unemployment

According to the Labor Department's Bureau of Labor Statistics ("BLS"), the unemployment rate was 6.1% in June 2014, down slightly from 6.3% in both April and May. Unemployment rates increased steadily throughout 2008 and into 2009, peaking at a level of 10% in October 2009. The October 2009 unemployment rate represented the highest level since 1983. The June 2014 rate is the lowest rate since September 2008. While the June unemployment rate is lower than rates observed over the past several years, the labor force participation rate is also generally lower.

Civilian Unemployment Rate



Source: Bureau of Labor Statistics

Macroeconomic Indicators // Housing

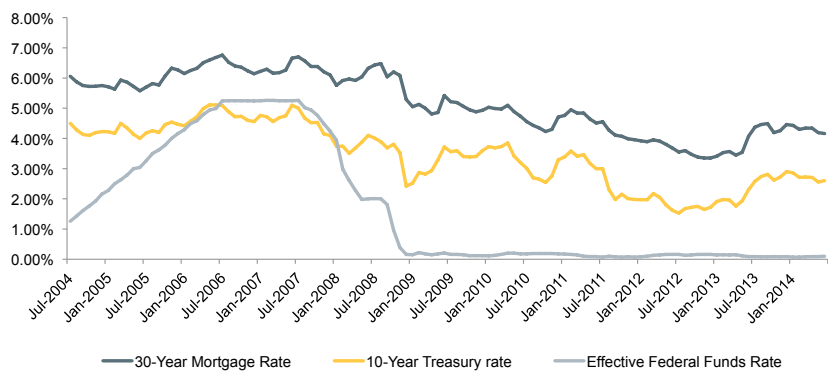
Traditionally, home owners have used home equity to purchase durable goods. When the housing market collapsed in late 2007, this method of financing was effectively cut off. The housing market has only gradually strengthened over the last five years despite sustained reductions in interest rates. Although the Federal Reserve has begun tapering the rate of asset purchases, a significant tightening of monetary policy (via an increase in the target federal funds rate) is unlikely in the short run until unemployment declines and inflation rises. Further, home building activity has traditionally been a primary driver of overall economic activity because new home construction stimulates a broad range of industrial, commercial, and consumer spending and investment. Housing starts have increased year-over-year, as have housing prices.

"The Committee continues to anticipate...that it likely will be appropriate to maintain the current target range for the federal funds rate for a considerable time after the asset purchase program ends, especially if projected inflation continues to run below the Committee's 2 percent longer-run goal, and provided that longer-term inflation expectations remain well anchored." — Federal Reserve FOMC statement June 18, 2014

Key Interest Rates

The Federal Reserve's Open Market Committee ("FOMC") lowered its target for the federal funds rate to a range of 0% to 0.25% during the fourth quarter of 2008, representing a total rate cut of 175 to 200 basis points during the quarter. Target rates were held steady during 2009 and have remained unchanged through the second quarter of 2014. This has kept interest rates low, increasing the ability of households to fund spending. The yield on the 10-year Treasury note is expected to increase during 2014, which could cause consumers to switch to used cars, as new car loans are less affordable.

Change in Key Interest Rates



Source: Federal Reserve Economic Data

Macroeconomic Indicators // Housing (cont.)

Housing Starts

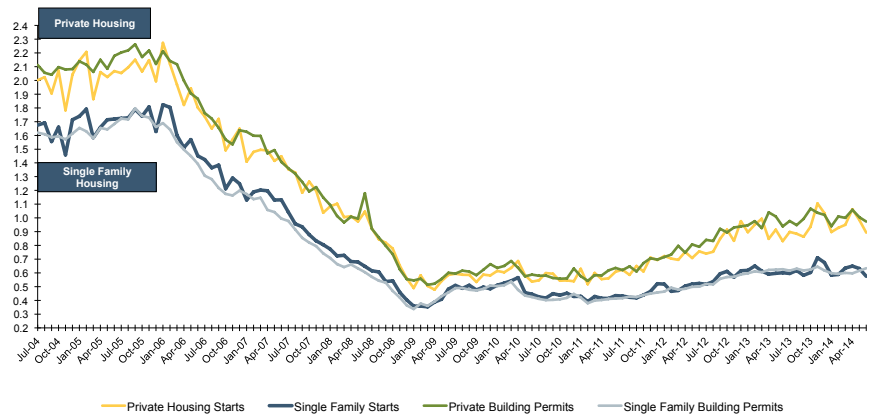
According to the U.S. Census Bureau, new privately owned housing starts were at a seasonally adjusted annualized rate of 893,000 units in June 2014, 9.3% below the revised May rate of 985,000 units, but 7.5% above the June 2013 level. The June 2014 level of housing starts represents a nine-month low and the decline between May and June was largely driven by a record drop of starts in southern states. The seasonally adjusted annual rate of private housing units authorized by building permits (considered the best indicator of future housing starts) was 963,000 units in June 2014, 4.2% below the revised May estimate of 1,005,000, but 2.7% above the June 2013 level.

Housing Prices

Housing prices have not yet recovered to pre-recession levels but have increased year-over-year since January 2011.

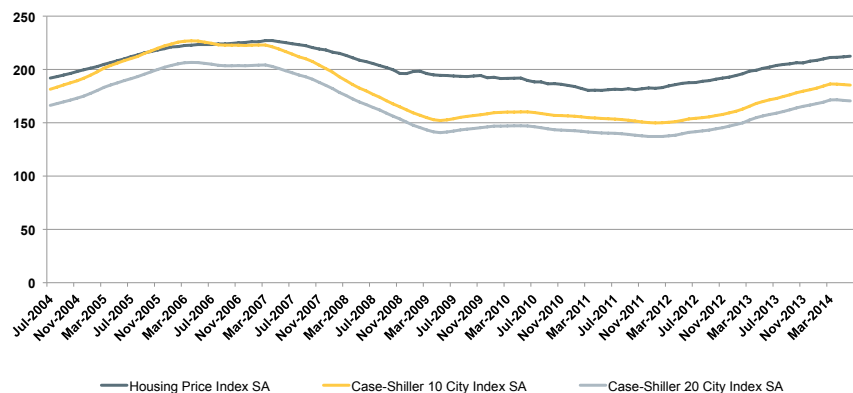
Seasonally Adjusted Annualized Rates of New Housing Starts and Building Permits

(millions of units)



Source: U.S. Census Bureau
 Note: Permits at a given date are generally a leading indicator of future starts. Beginning with January 2004, building permit data reflects the change to the 20,000 place series.

Change in Housing Prices



Source: Federal Reserve Economic Data

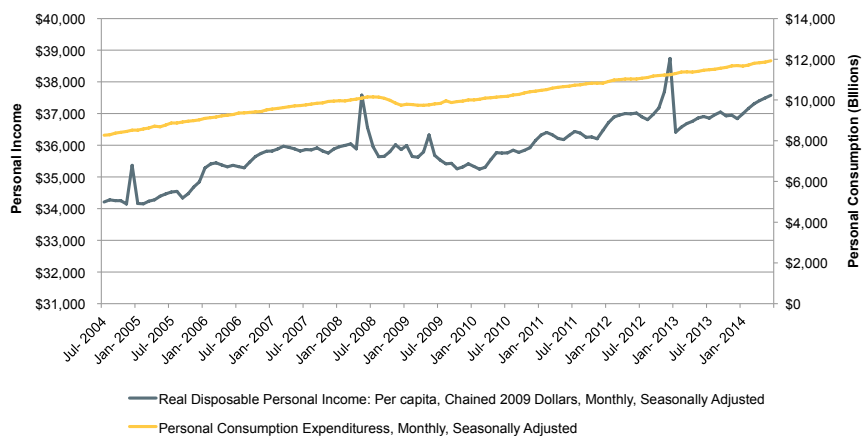
Macroeconomic Indicators // Personal Consumption & Confidence

Increases in disposable income allow for increases in personal consumption, especially debt-funded purchases like cars. However, these increases must keep pace with inflation. Further, increases in disposable income tend to increase confidence in consumers and business owners. Confident consumers have more optimistic expectations of the future: they expect a stronger economy, lower unemployment, higher future wages, and better ability to pay for debt-funded purchases. Similarly, confident businesses are a gauge of an economy's ability to employ labor productively in the future.

Disposable Income and Personal Consumption

Real personal income and personal consumption have both been steadily increasing year-over-year since 2010, partly due to growth and partly due to Federal Reserve policy keeping inflation near 0.0%. Further, disposable income is expected to continue rising through 2014.

Disposable Income and Personal Consumption

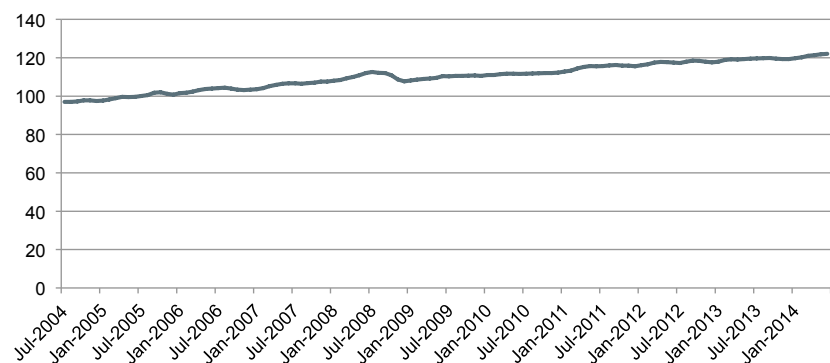


Source: Federal Reserve Economic Data

Consumer Price Index

The Consumer Price Index is a measure of inflation. While it has steadily increased since 2009, the Federal Reserve's monetary policy has kept inflation below its 2.0% target, keeping interest rates low and consumption high.

Consumer Price Index



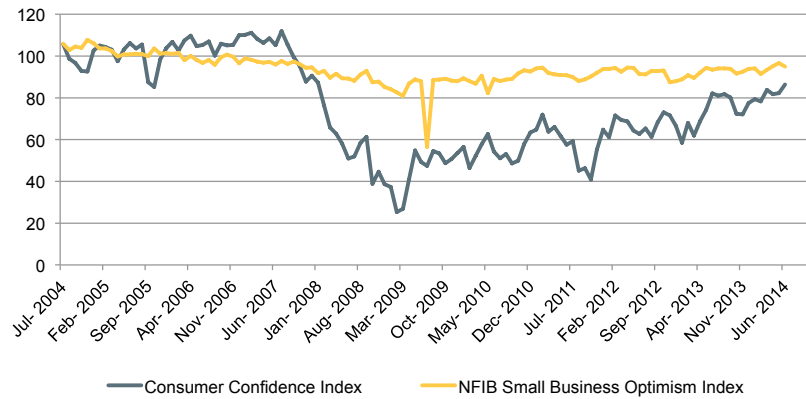
Source: The Conference Board

Macroeconomic Indicators // Personal Consumption & Confidence (cont.)

Confidence

Both consumer and small business confidence has been trending upward since the Great Recession. This confidence will drive demand for cars.

Change in Confidence



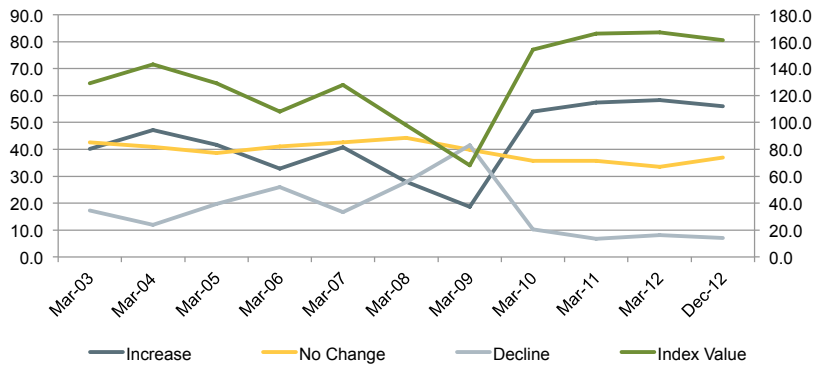
Source: Bloomberg, L.P.

Macroeconomic Indicators // NADA Dealer Optimism Index

NADA Dealer Optimism Index

According to the 2012 NADA Dealer Optimism Index, fewer dealers believed profits would continue to rise as of the December. However, the same survey showed dealer confidence has surpassed pre-recession highs, and current profits are expected to continue.

NADA Dealer Optimism Index



Source: NADA Data

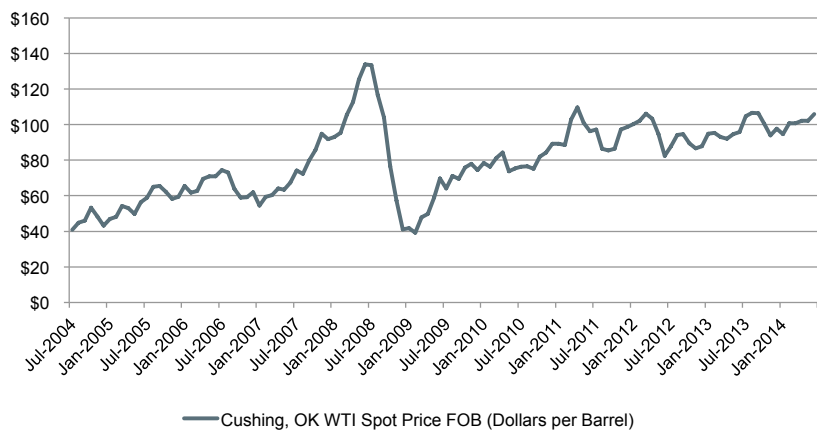
Energy

Energy prices not only impact the price of manufacturing a car, but also the running price of a car, as consumers must fill up on gas regularly. Increased environmental regulations have improved fuel economy of most cars but have also led to higher prices at the dealership. Consequently, consumer demand has shift toward more fuel efficient, typically smaller, vehicles.

Spot Oil

Oil prices have steadily increased since 2009 to historically high levels shifting consumer demand to hybrid and electric vehicles. World crude oil prices are expected to decrease through 2014 as supplies increase.

Spot Oil Prices

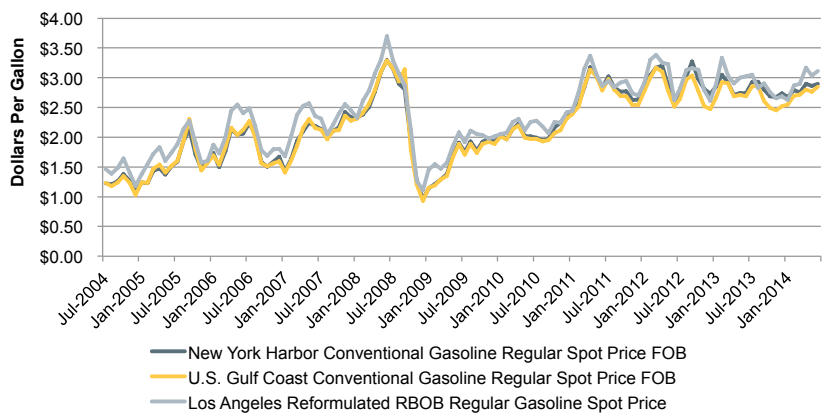


Source: Energy Information Administration

Gas

While gas prices have steadily rose since a sharp drop in 2008, they are expected to drop in the second half of 2014.

Gas Prices



Source: Energy Information Administration

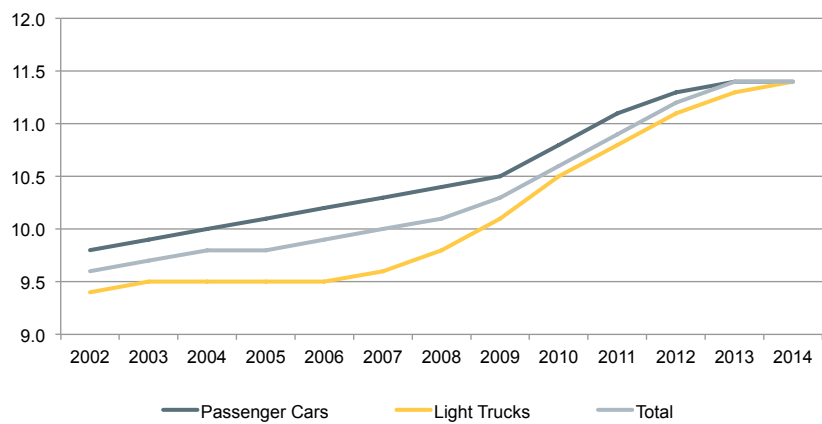
Auto Dealer Indicators // Average Dealer Profile

Macroeconomic measures including employment, productivity housing prices and starts, interest rates, and disposable income have provided an environment conducive to car purchases. However, rising prices, downward pressure on margins, and changes in demand have caused shifts in automobile demand.

Average Age of Vehicle Fleet

Polk, a global automotive market intelligence firm, has found that the average age of all light vehicles hit a record high of 11.4 years in 2013 due to the recent recession and rising car quality. Further, they expect this trend to provide more opportunities for the automotive aftermarket.

Average Age of Vehicle Fleet



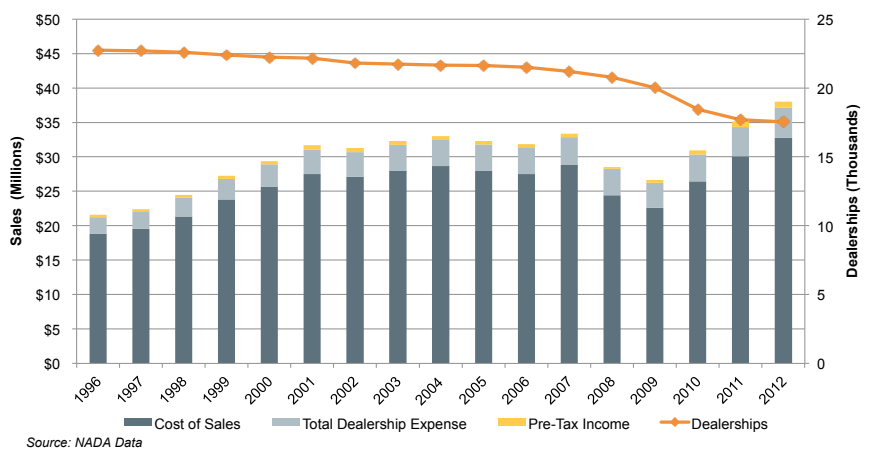
Source: IHS Automotive, driven by Polk

Dealership Sales

By the end of 2012, there was an increase of 95 franchised dealerships, the first annual increase since 1987.

Sales rose 9.2% in 2012, the second year in a row, above pre-recession highs. However, net profit before taxes gained only 6.2% as dealerships continued to experience margin compression. Current pressure on margins stems primarily from the fact that the asymmetric information that once favored dealers is balanced by internet sites such as Edmunds, cars.com, and autotrader.com.

Dealership Sales



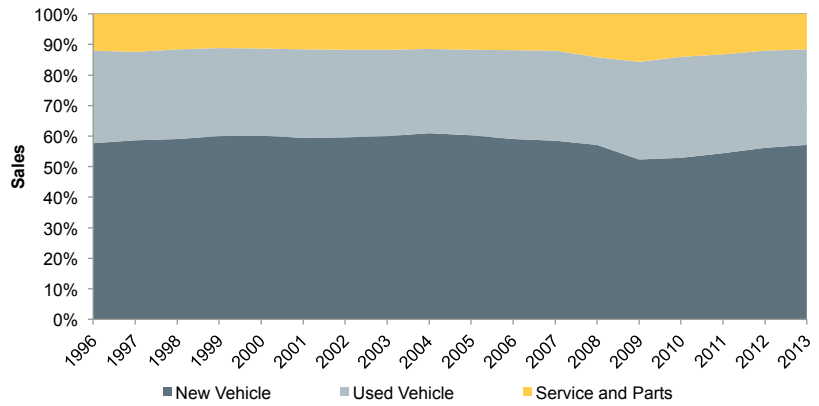
Source: NADA Data

Auto Dealer Indicators // Average Dealer Profile (cont.)

Products and Services Segmentation

From 2005 to 2010, the percentage of sales from used vehicles and service and parts segments of the industry rose, as financing new vehicle purchases became more difficult. Since then, new vehicles' share of sales has gone up, but has not recovered to pre-recession levels.

Products and Services Segmentation



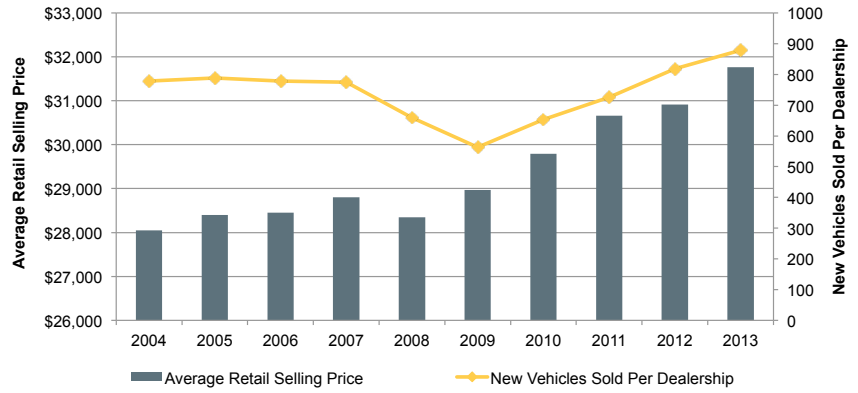
Source: NADA Data

Auto Dealer Indicators // Vehicles and Price

Vehicles and Price

Prices are being forced up by rising oil prices and increased environmental regulations. Average vehicles sold per dealership continued to rise even as the number of franchised dealerships increased.

Vehicles and Price



Source: NADA Data

Valuation Trends

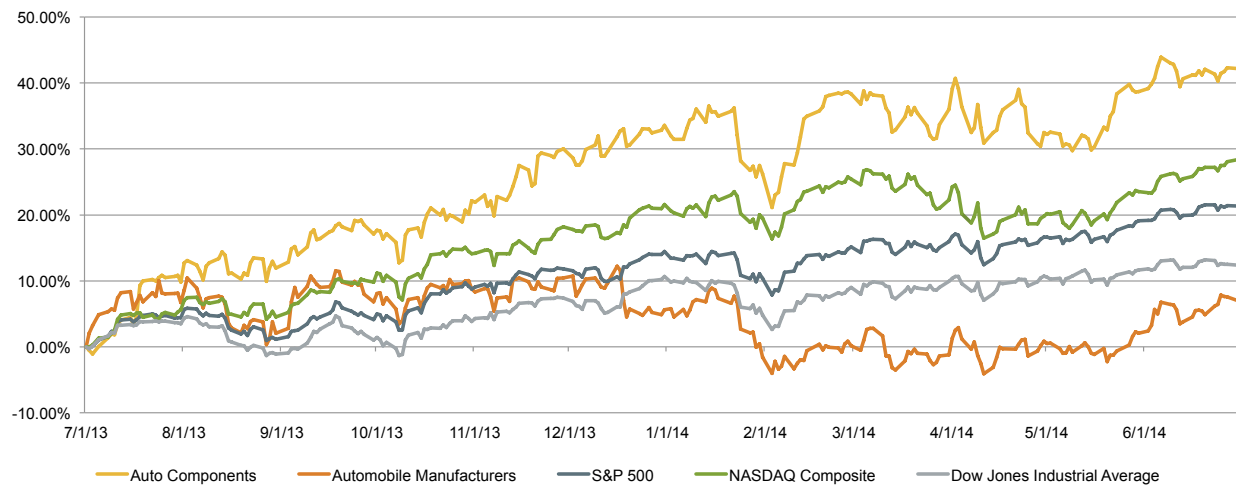
OEMs and Indices

Auto components have continued to outpace auto manufacturers reflecting continued increases in consumer spending on maintenance compared to pre-recession levels.

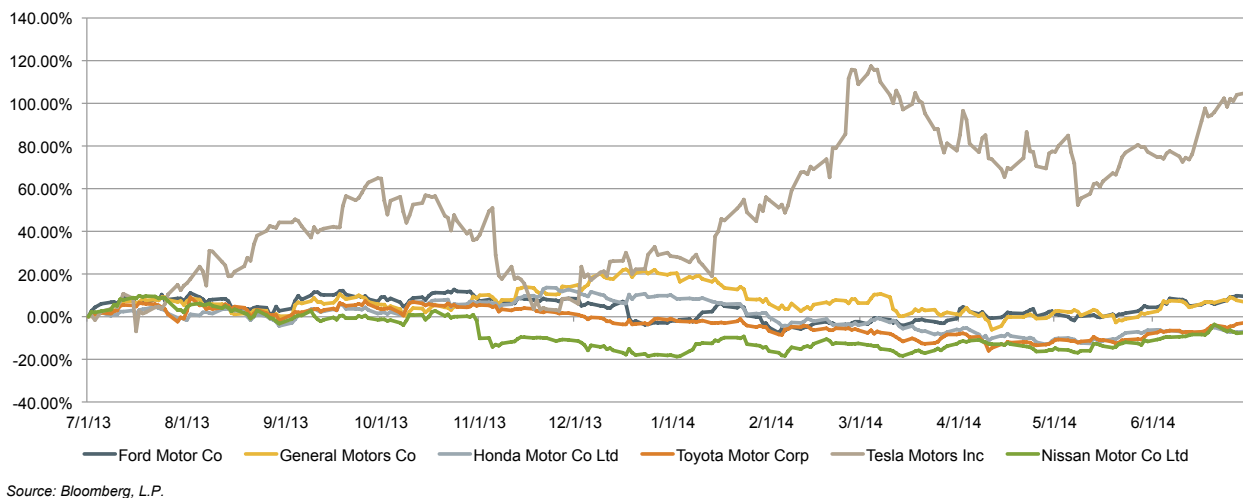
Tesla is outperforming all other auto dealers. They are on the forefront of electric vehicle technology. Their recent adoption of an open source

mentality in regard to their patents provided a boost in public perception. Lastly, despite their trouble with certain trade restrictions placed on them by particular states, they are increasing margins by removing the need for a physical dealership. AutoNation expects to make online sales by the end of the year.

Index Performance



OEM Stock Performance

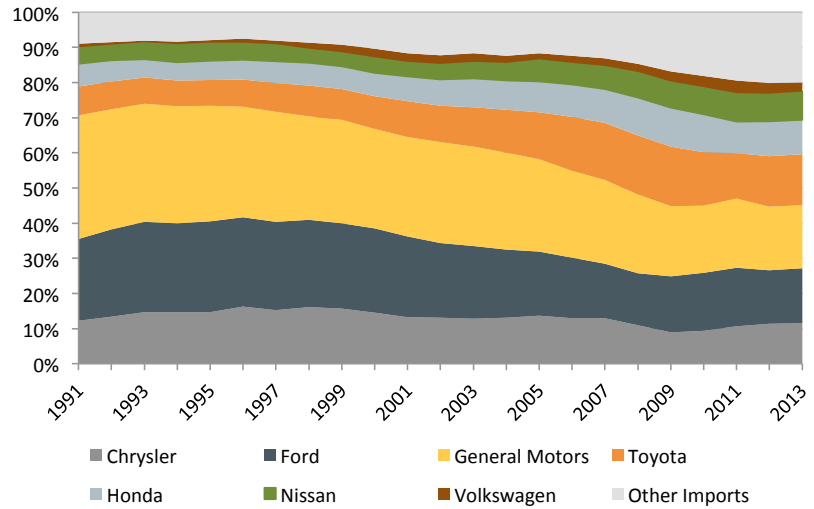


Valuation Trends (cont.)

Brand Market Share By Unit Sales

In 2012, Chrysler was the only member of the Detroit Three whose market share rose. Of the three major Japanese brands, Nissan's fell while Honda and Japanese brands gained market share. Other imports have been gaining market share.

Brand Market Share By Unit Sales



Source: NADA Data

Valuation Trends (cont.)

Publicly Traded Auto Dealerships

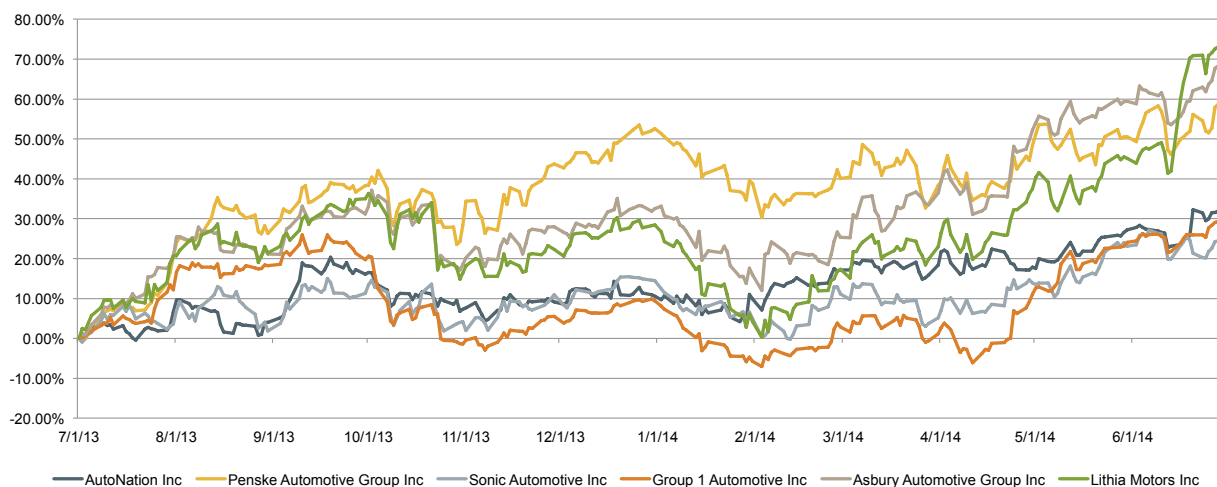
"AutoNation delivered its 15th consecutive quarter of double-digit year-over-year growth in EPS. We reconfirm our expectation of U.S. industry new vehicle unit sales to increase 3% to 5%, bringing U.S. industry new vehicle sales above 16 million units in 2014." *Mike Jackson, Chairman and CEO of AutoNation.* "AutoNation Reports Record Second Quarter EPS from Continuing Operations." 17 July 2014.

"Our business delivered another outstanding quarter, achieving over 20% growth in revenues, income from continuing operations and related earnings per share. I am particularly pleased with another quarter of double-digit, same-store retail revenue growth, further highlighting the benefit of our company's brand mix and geographic diversification. We remain confident in the strength of the auto retail market and our ability to continue growing the overall business." *Roger S. Penske, Chairman of Penske Automotive Group.* "Penske Automotive Reports Record Results." 30 July 2014.

"We posted a solid performance in the second quarter growing the top-line and gross profit in every revenue category. We are also very excited about the kick-off of our One Sonic-One Experience initiative in our Charlotte market during the third quarter of 2014. This initiative, combined with our pre-owned store initiative which we plan to open in Denver, Colorado during the fourth quarter of 2014, is one of the cornerstones which will enable Sonic to rapidly grow in the future." *B. Scott Smith, President of Sonic Automotive.* "Sonic Automotive, Inc. Reports All-Time Record Pre-Owned Unit Sales and Total Gross Profit." 22 July 2014.

"Our second quarter earnings were significantly impacted by several major factors. On the positive side, our U.K. operations continue to set new records with a revenue increase of 21.2 percent and a gross profit increase of 24.4 percent. Additionally, our U.S. business continues to grow nicely with revenue up 9.5 percent and increases across all of our major business segments. Also, we took major steps during the quarter to restructure our balance sheet by redeeming a large portion of our 3.00% Convertible Senior Notes and announcing the mandatory redemption of our 2.25% Convertible Senior Notes. This should reduce our ongoing diluted share count by approximately 2.2 million shares, which should provide a major benefit to our shareholders in the future. On the disappointing side, the Brazilian market deteriorated significantly during the quarter due to political and economic uncertainty, as well as major business disruption from the World Cup event. Our Brazilian revenue declined 18.8 percent on a new vehicle unit sales decrease of 22.3 percent. The deterioration in our Brazilian business represents a 15 cent reduction in our total adjusted EPS profit performance versus the comparable period last year." *Earl J. Hesterberg, President and CEO of Group 1 Automotive.* "Group 1 Automotive Reports 2014 Second Quarter Financial Results." 24 July 2014.

Auto Dealership Stock Performance

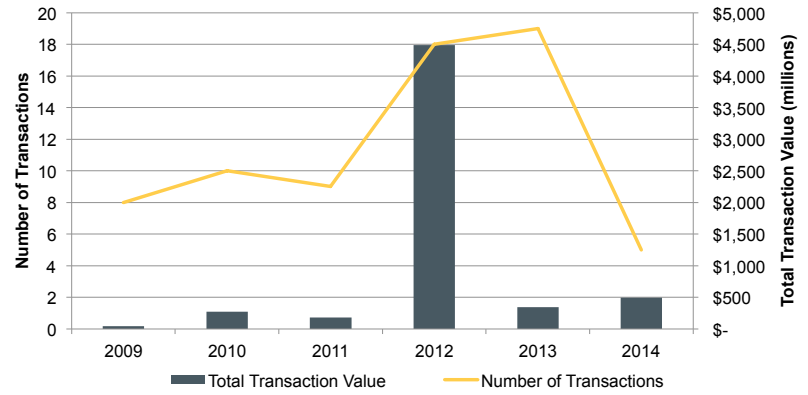


Source: Bloomberg L.P.

Mergers and Acquisitions

Deal activity in 2013 slowed somewhat in terms of aggregate deal value, but the number of transactions has increased. Deal value in the first six months of 2014 has surpassed all of 2013.

M&A Activity



Source: Capital IQ

Guideline Company Pricing

Auto Manufacturing Pricing

Company Name	Ticker	30-Jun Price \$	52 Week Perf. %	LTM		Ent. Value \$ Mil	Debt / Equity %	EBITDA Margin %	EV / Sales Multiple x	EV / EBITDA Multiple x	EV / Nxt Yr EBITDA Multiple x	Price / Earnings x
				Sales \$ Mil	EBITDA \$ Mil							
Ford Motor Co	F	17.12	12.56%	146,299	11,482	185,096	443.33%	7.85%	1.27	16.12	16.78	10.57
General Motors Co	GM	35.99	8.61%	156,525	11,303	100,761	103.06%	7.22%	0.64	8.91	6.62	32.25
Honda Motor Co Ltd	HMC	34.99	-4.71%	118,765	15,658	120,752	97.75%	13.18%	1.02	7.71	9.67	11.00
Hyundai Motor Co	005380.KS	226.91	16.26%	40,040	5,310	49,825	4.58%	13.26%	1.24	9.38	nm	11.59
Toyota Motor Corp	TM	119.66	0.03%	255,686	35,646	542,088	112.05%	13.94%	2.12	15.21	16.03	20.74
Tesla Motors Inc	TSLA	240.06	104.87%	2,436	48	32,359	257.33%	1.99%	13.28	668.70	40.25	nm
Nissan Motor Co Ltd	NSANY	18.97	-4.44%	106,079	11,979	136,223	134.12%	11.29%	1.28	11.37	13.36	19.16
Peugeot SA	PEUGF	14.72	54.75%	73,265	5,186	54,944	329.91%	7.08%	0.75	10.59	11.31	nm
Average		88.55	23.49%	112,387	12,076	152,756	185.27%	9.48%	2.70	93.50	16.29	17.55
Median		35.49	10.59%	112,422	11,393	110,756	123.09%	9.57%	1.25	10.98	13.36	15.37

Source: Bloomberg L.P.

Guideline Company Pricing

Company Name	Ticker	30-Jun Price \$	52 Week Perf. %	LTM		Ent. Value \$ Mil	Debt / Equity %	EBITDA Margin %	EV / Sales Multiple x	EV / EBITDA Multiple x	EV / Nxt Yr EBITDA Multiple x	Price / Earnings x
				Sales \$ Mil	EBITDA \$ Mil							
Traditional Auto Dealers												
AutoNation Inc	AN	59.68	32.80%	18,147	878	11,827	223.63%	4.84%	0.65	13.47	12.61	18.31
Penske Automotive Group Inc	PAG	49.29	62.92%	16,134	539	8,187	229.60%	3.34%	0.51	15.20	13.03	16.27
Sonic Automotive Inc	SAH	26.65	25.30%	9,047	288	3,391	304.03%	3.18%	0.37	11.77	10.95	14.03
Group 1 Automotive Inc	GPI	84.13	31.16%	9,392	329	4,367	240.47%	3.50%	0.46	13.27	12.53	22.08
Asbury Automotive Group Inc	ABG	68.74	69.52%	5,623	278	3,246	219.29%	4.94%	0.58	11.69	9.94	17.95
Lithia Motors Inc	LAD	93.90	75.53%	4,394	225	3,547	185.13%	5.12%	0.81	15.78	10.66	20.91
Average		63.73	49.54%	10,456	423	5,761	233.69%	4.15%	0.56	13.53	11.62	18.26
Median		64.21	47.86%	9,220	309	3,957	226.61%	4.17%	0.54	13.37	11.74	18.13
Used Auto Dealers												
America's Car-Mart Inc/TX	CRMT	39.55	-9.16%	435	(14)	443	45.58%	-3.33%	1.02	nm	9.11	17.66
CarMax Inc	KMX	52.01	11.39%	13,013	973	19,327	239.20%	7.47%	1.49	19.87	18.55	22.71
Average		45.78	1.12%	6,724	479	9,885	142.39%	2.07%	1.25	19.87	13.83	20.18
Median		45.78	1.12%	6,724	479	9,885	142.39%	2.07%	1.25	19.87	13.83	20.18

Source: Bloomberg L.P.

Sources

"IBISWorld Industry Report 44111: New Car Dealers in the US"

"IBISWorld Industry Report 44112: Used Car Dealers in the US"

"NADA Data" 2002-2014. <http://www.nada.org/Publications/NADADATA/>.

"Polk Automotive Industry Dashboard." <https://www.polk.com/knowledge/reports>.

Mercer Capital

Auto Dealer Industry Services

Mercer Capital has expertise providing business valuation and financial advisory services to companies in the auto dealer industry.

Mercer Capital provides business valuation and financial advisory services to auto dealerships throughout the nation. We provide valuation services for tax purposes, buy-sell agreements, partner buyouts, and other corporate planning purposes. Mercer Capital also works with owners who are considering the sale of their dealership or the acquisition of other dealership(s).

Services Provided

- Valuation of auto dealer industry companies
- Transaction advisory for mergers, acquisitions and divestitures
- Valuations for purchase accounting and impairment testing
- Fairness and solvency opinions
- Litigation support for economic damages and valuation and shareholder disputes

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