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Auto Dealer Industry

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Mercer Capital is a national business valuation and financial advisory firm. Valuations of auto dealers require special knowledge of the industry, hybrid valuation methods, and understanding of industry terminology. This newsletter provides useful statistical metrics of the auto industry as well as content about the unique industry factors and value drivers of business valuations. We can assist you and your clients in valuation and consulting matters within the auto industry.

We hope you find this newsletter to be a helpful resource and appreciate any feedback along the way. Please send suggested content topics or ideas that you'd like to see in future editions to Mercer Capital's Auto Dealer Industry Group Leader, Scott A. Womack, ASA, MAFF at **womacks@mercercapital.com**.

2022: How Is the Auto Industry Doing and What Does the Future Hold?

Status Quo or Winds of Change?

With the first half of 2022 behind us and school started, report cards will be here before we know it. In that same light, the auto industry has published its statistics for the first six months. This article reviews **predictions** by industry analysts (and us) made at the beginning of the year by analyzing several key metrics. Additionally, we discuss threats that arose during the first half of 2022 and their impact on the auto industry for the remainder of the year and perhaps longer. Finally, we offer a few predictions for the second half of 2022.

Review of 2022 Predictions

Most analysts predicted vehicle sales would continue to improve in 2022 due to pent-up demand from vehicle deficits caused by production shortfalls in the last two years. While demand would continue to outpace supply, analysts believed the tight supply of new vehicles would gradually improve in 2022. Finally, analysts predicted that the production of microchips would begin to see some improvement this year.

Recall the original causes of the microchip shortage stemmed from the following events: 1) OEMs canceled orders of microchips in the early days of COVID-19 as the production of new vehicles waned in the aftermath of shutdown orders for OEM plants and dealerships alike; 2) there was a huge increase in the demand of consumer electronics; and 3) supply chain disruption from the production and plant shutdowns of the microchip factories themselves.

Mercer Capital predicted a similar bounce back in the production of new vehicles stemming from the vehicle deficit of the last two years. We also predicted there would be fewer incentives offered by manufacturers, fewer models available, and fewer features on vehicles.

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2022: How Is the Auto Industry Doing and What Does the Future Hold?

Status Quo or Winds of Change?

(cont.)

New Threats in 2022

Through the first six months of the year, new threats to the auto industry and the general economy emerged. Headlines are dominated by inflation (at the highest levels in 40 years), rising interest rates, and rising gas prices. The auto industry is impacted directly or indirectly because these economic headwinds affect a consumer's ability to purchase and finance a new or used vehicle, as well as the total vehicle miles traveled.

Also contributing to these threats is the Russian invasion of Ukraine and its impact on the production shortage of microchips. Raw materials, such as neon gas that has been compromised during this war, are a key component in the manufacturing of microchips. Additionally, the war has caused production plant shutdowns and further supply chain disruptions for OEM and microchip plants located in/or adjacent to the area.

OEMs and the United States are trying to mitigate the impact of the microchip crisis and our dependence on importing these components by opening microchip production facilities domestically, but these will take some time to develop and begin production. Analysts, ourselves included, may have been too optimistic as to how quickly this industry could scale supply to meet increasing demand.

If the current market conditions of inflation, rising interest rates, and rising gas prices lead to a recession, there could be further impacts on the overall auto industry. Yet, depending on your definition, we may already be in a recession. U.S. auto sales declined by 40% during the Great Recession and fell nearly 15% for the first two months of COVID-19, compared to those same two months in 2019.

New Vehicle Profitability

With high demand, tight supply, and fewer incentives offered by the manufacturer, it's not a surprise that the average transaction prices of new vehicles have been at record levels in 2022. One interesting trend has been the increased shift towards crossovers and light trucks compared to smaller cars which are more fuel efficient. It remains to be seen whether rising gas prices will swing this pendulum back.

2022: How Is the Auto Industry Doing and What Does the Future Hold?

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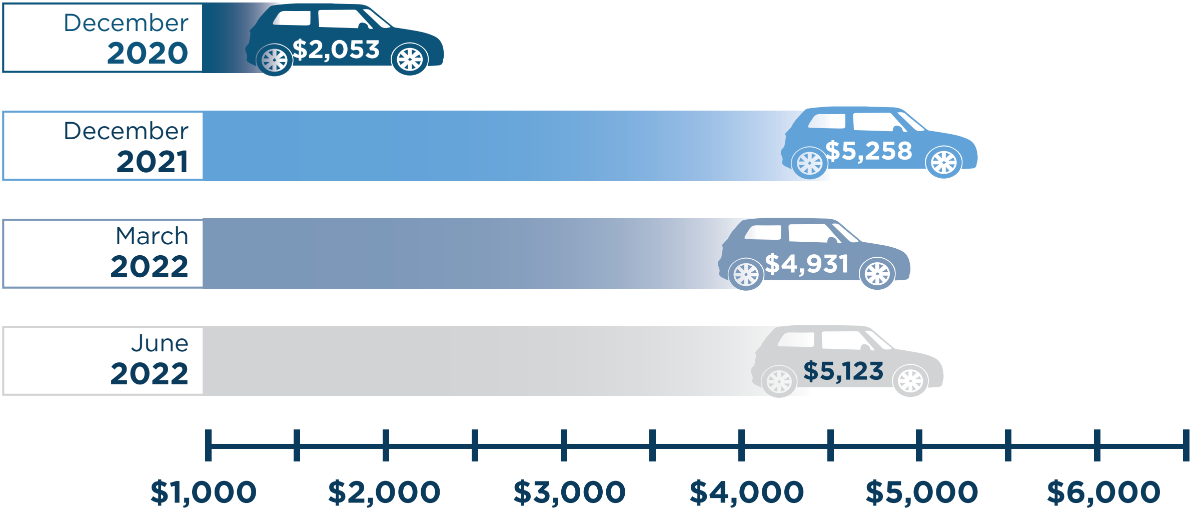
(cont.)

In addition to high vehicle prices, auto dealers' total retailer profit per unit has also reached record levels. According to the monthly forecasts from **J.D. Power** and **LMC Automotive**, profitability from this metric has been between $4,900 and $5,300 per unit since December 2021. As a point of comparison, this same metric totaled only $2,053 per unit in December 2020, as seen in the graphic below.

Total Retailer Profit Per Unit - Inclusive of Grosses and F&I Income



Source: JD Power - LMC Automotive Monthly Forecasts

While the monthly totals in the first and second quarters of 2022 fluctuated slightly, there doesn't seem to be any indications of this trend changing.

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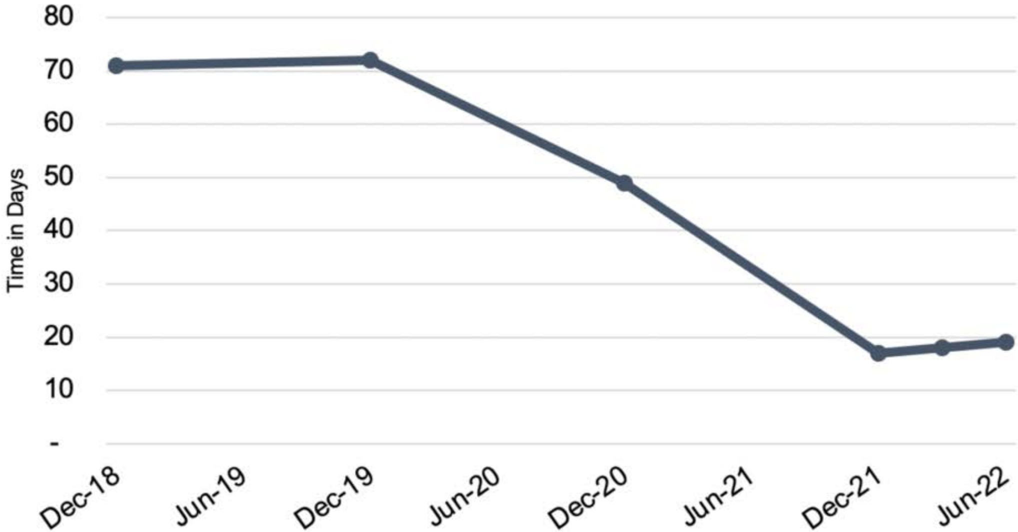
(cont.)

Supply of New Vehicles

Evidence of the tight supply of new vehicles in the last few years can also be seen in the lack of inventory on auto dealer lots across the country. It is not uncommon to see empty spots on the lot.

Another measurement is the average time in days that a new vehicle sits on the lot before it is purchased. The monthly forecasts provided by J.D. Power and LMC Automotive report these figures between 19 and 20 days for each month in the first half of 2022, a slight uptick in the December 2021 figure of 17 days. As a point of comparison, this metric totaled 72 and 71 days for December 2018 and December 2019, respectively, as seen in the graph below.

Average Time New Vehicle on Dealer's Lot



Source: JD Power - LMC Automotive Monthly Forecasts

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(cont.)

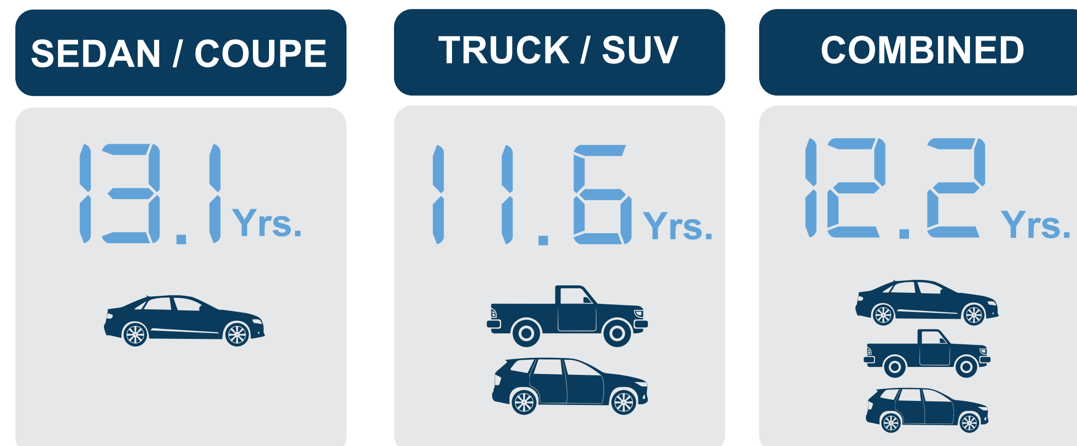
In our discussions with auto dealer clients, they continue to indicate that they are operating on a selling volume of 50-75% of pre-COVID years, but at 2-3x greater gross profit – a further reflection of these first two metrics. Dealers and industry analysts both predict the OEMs will increase the supply of new vehicles above current levels when they are able to try and reclaim some of their lost profitability on these units.

While most analysts and dealers do not predict the average day's supply will reach pre-COVID levels, there is certainly room between current and prior-year levels. Based on this statistic and overall industry conditions, any improvement in supply seems to be minimal and gradual through the first half of the year. Trying to predict when supply issues will be resolved feels like predicting when Tom Brady will retire.

Average Age of Cars

S&P Mobility recently released its annual study on the average age of cars on the road in the U.S. As the graphic below indicates, the overall combined average is 12.2 years, only slightly above 2021's figure of 12.1 years.

Average Age of Cars on the Road



Source: S&P Mobility

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(cont.)

The combined average of cars on the road has grown every year for over a decade. This figure show no signs of decline and will likely continue to rise if a recession hits. At some point, conventional wisdom says the average age of cars will peak and begin to decline as consumers have to trade in for a more recent model. However, OEM improvements may structurally improve vehicle life cycles just as many hot new features have quickly become standard.

The average age of cars also highlights the continued opportunity for auto dealers in terms of fixed operations (service department and parts). Aging cars will require more service than newer vehicles. This opportunity could be mitigated somewhat during a recession, as consumers could be apt to drive fewer miles due to rising costs or lack of employment. In fact, another statistic affected by a recession is total vehicle miles driven. This figure declined sharply for the two years during the Great Recession and also declined rapidly from the effects of COVID-19.

The rolling twelve-month average for total vehicle miles driven has finally climbed back to near pre-pandemic levels as of May 2022 (most recently published data). A market recession could easily reverse that trend for the remainder of the year and the length of the recession.

Average Trade-In Equity Value of Used Cars

Like new vehicles, used vehicle transaction prices also reached record highs in 2022. While the supply of used vehicles has improved gradually, like its new vehicle counterparts, it has not returned to pre-COVID levels. Since fewer new units are available for sale, fewer used vehicles are traded to the dealer. However, the average trade-in equity value for used cars has followed the same trends as profitability on new and used vehicles. According to the monthly forecasts from J.D. Power and LMC Automotive, the average trade-in equity value has ranged between $9,300 and $10,400 since December 2021, compared to $5,626 just one year prior in December 2020 (see the graph on the next page).

Rising trade-in values and, perhaps more importantly, equity are key components of rising vehicle prices. Through the first six months of 2022, there was no sign of trade-in values cooling, although those could be impacted in the coming months by the emerging new threats or the onset of a recession. Consumers tend to be more focused on their monthly payment, so a $5,000 increase on vehicles purchased and traded in are a wash to the consumer. If this metric begins to stumble, we expect it to impact transaction prices similarly.

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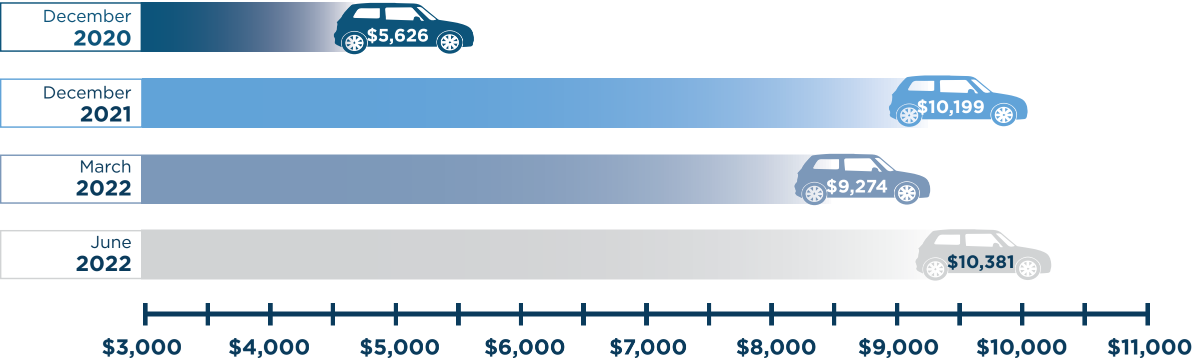

Fleet Sales

In more robust times of new vehicle production, dealers can sell off high volumes of excess inventory to rental car companies, government agencies, and corporations, albeit at much lower margins. Fleet sales were significantly impacted by COVID-19 as rental car companies sold off large portions of their fleet to conserve cash as consumers were no longer traveling during stay-at-home orders.

Fast forward two years, rental car companies and others have not been able to replenish their fleets as the entire industry has been operating at a new vehicle deficit. Anyone that has tried to rent a car in the last few years has experienced a lack of availability and heightened prices. We have a friend who recently rented a U-Haul truck on vacation because the price was half of a rental car. While these conditions have improved recently, fleet sales and corporate fleet sizes still represent a distressed industry segment.

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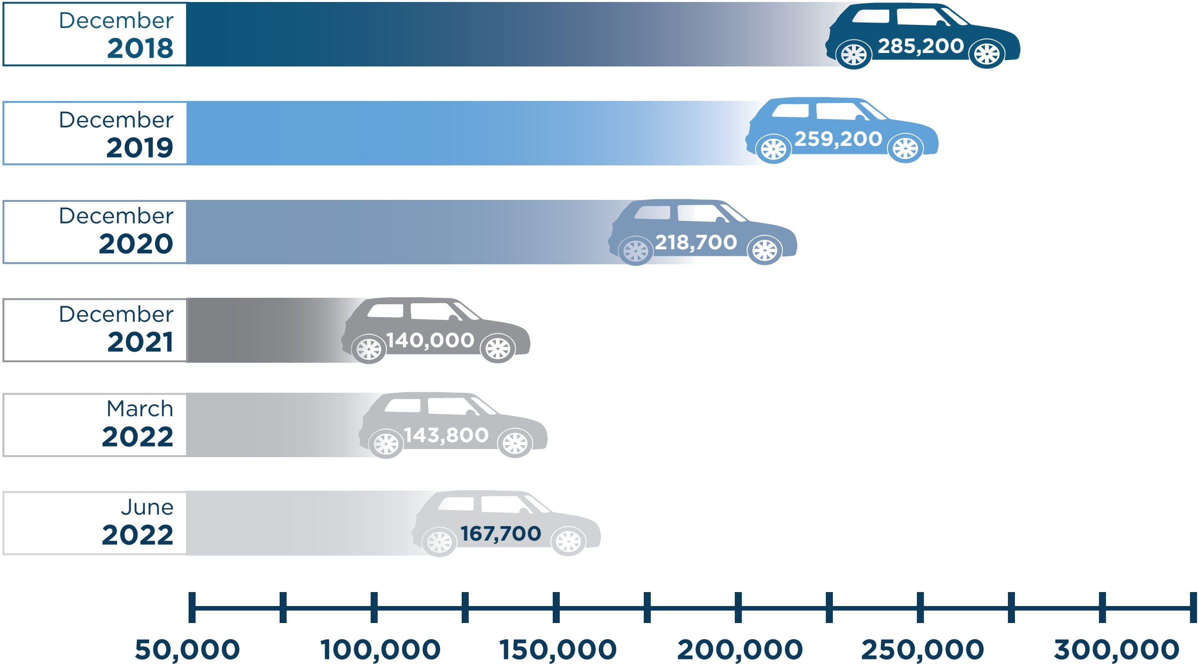
(cont.)

As reported by J.D. Power and LMC Automotive, monthly fleet sales rebounded somewhat in the first half of 2022, but their monthly unit sales are still down almost 50% from prior levels depending on the month, as seen in the graphic below.

Monthly Fleet Sales



Source: JD Power - LMC Automotive Monthly Forecasts

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Status Quo or Winds of Change?

(cont.)

Another view of fleet volumes can be measured by the percentage of sales of fleet vehicles vs. the overall sales of all new vehicles. According to **Cox Automotive**, fleet sales have comprised approximately 13-14% of overall new vehicle sales for 2020, 202, the first half of 2022, compared to nearly 19% in 2019. It should also be noted that those reduced percentages representing fleet share are also on greatly reduced overall new unit sales from the same time periods.

Conclusions

So, how did industry analysts and Mercer Capital do on their beginning of the year predictions, and where are we headed? **Jonathan Smoke from Cox Automotive** originally predicted 2022 SAAR at 16 million units. He lowered that prediction to 14.4 million units in July. The predicted trends of high demand, tight supply, and increased profitability have all held through the first six months, although there are signs of softening in new vehicle sales with continued production shortages and rising interest rates. While optimism remains, we are running out of time in 2022 to revert to higher levels, so we expect these predictions to continue to be revised towards where performance has been.

How did Mercer Capital do with some of our predictions? While we were correct on fewer incentives from the manufacturers and fewer models available with fewer features offered on those vehicles, we were incorrect in predicting a higher SAAR in 2022.

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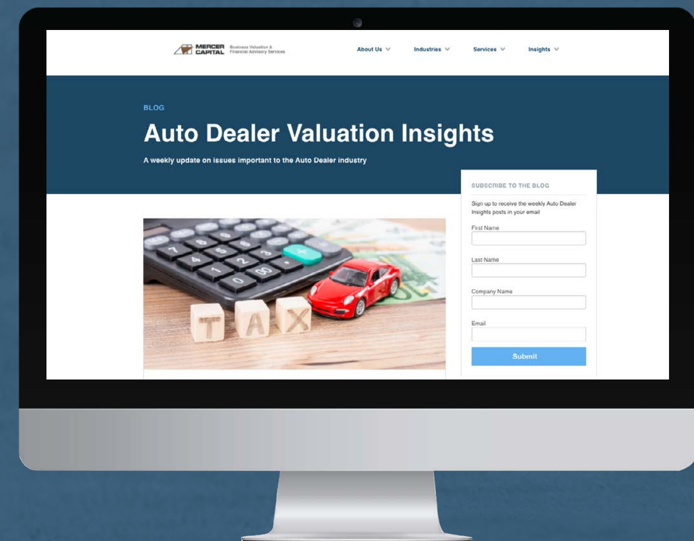

Earnings Calls

Executive Summary

Supply issues continue to dominate the industry with no end in sight. New vehicle days' supply is significantly below used vehicle supply, given the numerous channels through which used vehicles can be acquired. As one would expect, supply chain issues have less impact on domestic dealerships than imports, particularly luxury.

Many dealers currently have a significant number of pre-sold vehicles, which would account for either 0 or 1 days' supply if these vehicles were on the lot. While days' supply in the teens seems astronomically low compared to 60+ days pre-COVID, the level of pre-sales some dealers are seeing in actuality means either there are timing issues with reporting or the vehicles that aren't pre-sold are staying on the lot much longer. For example, if a dealer has 50% pre-sold and reports 30 days' supply, that means 50 cars are sold in 0 or 1 day, and the others are sitting on the lot for two months. We find this to be an interesting dynamic and wonder if it means OEMs have yet to perfect which models to build, even when prioritizing the most popular vehicles.

The question was raised: what do long-term expectations look like, given that the benefits of higher prices have primarily flowed to the dealers in this cycle? One analyst suggested dealers might be at peak earnings (which Group 1 said wasn't the case) and that OEMs are starting to see that maybe this is a more sustainable model for everyone. Another analyst noted that dealer margins have tripled in the past couple of years while margins of North American producers have been stable and asked why they haven't repriced some of their vehicle invoices. AutoNation's CEO Michael Manley indicated that the reduction in incentives has effectively improved the net transaction price of their vehicles. However, he conceded that OEMs facing rising costs would likely look to adjust margins going forward.

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Earnings Calls

Executive Summary (cont.)

We are going to go ahead and call our shot that a theme next quarter may be share buybacks. This type of capital allocation decision is not unique to auto dealers and, therefore, is not really an industry "theme," but we still find it notable. The recently passed *Inflation Reduction Act* came together after earnings were released, and each call mentioned share buybacks as an ingredient in the capital allocation strategy with no mention of the Act.

Share buybacks will now be subject to a 1% tax, and it remains to be seen whether that will be enough to deter the activity. As Group 1 Automotive's CEO Earl Hesterberg said this quarter, share buybacks come with no execution risk, unlike M&A. While this opportunity is not available to private auto dealers, both public and private dealers must figure out the best return available on the heightened profits they're receiving while the inventory shortage persists. Winners and losers will likely be separated by what investments are made before profits normalize.

As valuation analysts, we like to note any mention of valuation multiples offered by the public auto dealers, which are pertinent to our private dealer clients. Lithia reiterated its valuation targets (purchase prices 15-30% of revenues, 3x-7x EBITDA, and a minimum of 15% after-tax returns). This quarter, Penske offered their views on current valuations in the marketplace, which are more in keeping with how auto dealers communicate value (in terms of Blue Sky multiples). Mr. Penske said,

> *"If you're looking at a premium luxury, German brand, so BMW and Mercedes, Porsche, Audi you're looking at probably eight or nine times trailing 12 EBT for goodwill plus assets would be what we see. We've been able to make acquisitions for less than that where they're smaller and maybe not in the premium luxury side. Toyota and Honda are very strong. And to me, there are some people that just are going to get out of the business at the point. I think there is competition out there to buy these better points. But what's happening is many of us are running into what we call framework agreements which limit the amount of stores you can have in a particular market or with a particular brand."*

While this appears to be within the range of Haig's quoted multiples for these brands, it is essential to note that this is on trailing earnings or, as one analyst suggested on a different call, "peak" earnings. If a dealer was making $1.5 million pre-pandemic and is now making closer to $3 million, Haig's 3-year average might suggest "ongoing" earnings of $2.5 million. Applying Haig's average mid-point multiple for these four brands (approx. 8.2x), Blue Sky would be approximately $20.5 million. Taking Penske's midpoint 8.5x multiple on LTM earnings of $3 million, Blue Sky's value is $25.5 million, or an increase of 24.4%.

Earnings Calls

Executive Summary (cont.)

We also found it interesting that Porsche and Audi were put on the same playing field in terms of multiples, while Haig's Q1 newsletter suggested Audi was closer to 6.75x while Porsche was 9.5x.

The comment on framework agreements is also perhaps a different spin on this discussion. While the public dealers have been more acquisitive lately, dealers may not want to wait too long to sell as the buyers able to pay the most may soon run out of runway to complete acquisitions unless a fundamental shift occurs in how many dealerships one company can have in a brand or market.

Here are some other major themes from the Q2 2022 Public Auto Earnings Calls.

Theme 1: Dealers continue to pre-sell a significant amount of their new vehicles, particularly compared to pre-pandemic pre-sales levels. With questions about an agency model, it is unclear what the long-term rate of pre-sales will look like once inventories normalize.

> *"I think the new car business is solid, but it's really hard to understand how strong it is because you have such a low days' supply. Generally speaking, we're still pre-selling half the cars that are coming in. So a lot of these cars aren't getting to hit the ground. It varies a little bit by brand, but generally, that's where it is overall."*
> **– David Hult, CEO, Asbury Automotive Group**

> *"When you look at our domestic business, about half of our pipeline is pre-sold. When you look at our volume imports, it's 80%, some as high as 95%. And when you look at our luxuries, it's in the 60% range. And that is right where it's been for the last couple of quarters."*
> **– Daryl Kenningham, President, U.S. and Brazilian Operations, Group 1 Automotive**

> *"I would say on new vehicles, about one-third of our product is pre-sold that's coming in. So that's good. And I think it's a lot of high-demand vehicles. The rest of the stuff may be wait-listed, but it's not pre-sold where we have money on the car. […] We don't have the exact data. We got it by franchise somewhere. But I would say it was close to 50% 90 days ago. So since interest rates have come up, it's definitely affected things, but it's still a robust environment where those cars hit the ground. And if someone that wants to drive the car and there's two other people waiting to drive the same car, and it's still a bit of a frenzy."*
> **– Bryan DeBoer, President and CEO, Lithia Motors**

Earnings Calls

Executive Summary (cont.)

"Demand is strong as we mentioned. Inventory levels are still incredibly low, high turn rates, and really sustained margins over the last few quarters. In the first quarter, from memory, I reported something like 50% of our incoming three months' inventory was sold. I would say that on the domestic side, that is now down to about 35%. On imports, it is sustained, and on premium, it is also largely sustained."

– Michael Manley, CEO, AutoNation

Theme 2: As one might expect, the degree of unavailability when it comes to the inventory shortage depends on both make and model, with more desirable vehicles being in shorter supply. With global supply chain issues, it also makes sense that domestic vehicles are more readily available.

"Similar to the last few quarters, we continue to see limited new vehicle production and inventory levels due to supply chain disruptions and strong consumer demand for new vehicles. This contributed to a 33% decrease in same-store retail new vehicle unit sales volume higher than the industry retail SAAR decline of 20% due to our luxury and import weighted brand mix, which continues to have lower days' supply of inventory than domestic brands"

– David Smith, CEO, Sonic Automotive

"Our domestic days' supply on new is around 60 days. So we have pretty good flow even though there's some in-transit on that. Really our softness in days' supply, which is where we really are selling every car that we get about as quick as we can get them is in our imports, which we're sitting at a 16-day supply and our luxuries are sitting at about a 29-day supply."

– Bryan DeBoer, President and CEO, Lithia Motors

"We have a 21-day supply of new vehicles with premium at 23, volume foreign at 8, and domestic at 21. New vehicle supply is at 12 days in the U.S. and 32 days in the U.K. We continue to sell into our future new vehicle pipeline to support tour customers, maximize inventory turn and minimize our inventory costs."

– Roger Penske, Chairman & CEO, Penske Automotive Group

Earnings Calls

Executive Summary (cont.)

Theme 3: Continuing a theme from last quarter, analysts asked if executives were seeing signs of a struggling consumer. They also wondered if banks were being tighter with credit, given macro headwinds and inflated vehicle prices, though the public auto dealers generally downplayed concerns. When Penske was asked about entering the captive finance space, their response indicated a level of concern about the strength of the consumer. An analyst offered that there was a tiny sequential erosion in the strength of the consumer, but it was still strong relative to pre-pandemic and relative to supply, with which AutoNation agreed.

"With consumers financially healthy, consumer financing readily available, the car park aged to record levels and sizable pent-up demand combined with our technology to improve efficiency and productivity, we are well-positioned to weather the current market conditions. […] I would say people were impulsively buying six months ago. They're probably putting a little bit more thought and care into the selection and the pricing right now."

– David Hult, CEO, Asbury Automotive Group

"We're seeing no tightening whatsoever. When you think about the asset class performed very well in 2008 and '09. And when I talked to the head of these finance companies, as I said, they're seeing some delinquency increase on the lower end but it's back to pre-COVID levels. But I think the reassuring part of that is losses are historic lows and the appetite for car loans is robust. So, we have not lost any car business because of the availability of credit."

– Peter DeLongchamps, SVP, Manufacturer Relations, Financial Services and Public Affairs, Group 1 Automotive

The demand is there, but the demand is not there for a $640 monthly payment for pre-owned that's what you're getting and you're selling a 1- to 4- year car right now at $30,000 to $31,000. And so retooling to the 5-year-old plus cars, we're able to get that monthly payment back down into the $400 range, which is historically where it needs to be. So, consumers are buying a little higher amount car at a lower payment. And we've been able to continue to keep our warranty penetration up there. So not concerned at all about pre-owned demand."

– Jeff Dyke, President, Sonic Automotive

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Earnings Calls

Executive Summary (cont.)

"Today with delinquencies going up on retail across all other markets, I wonder — and then you're going to blow up your balance sheet. And on top of that you're going to have to take that and sell it into the market and securitize it. And I think today, the people that buy that are going to say is this really what we want to buy 72-month or 60-month paper from the standpoint in the car business with the inflation that we've had on used car prices? So not that we won't ever get into it, but we think it's a bad idea. Right now, we don't think that glove fits our hand."
– Roger Penske, Chairman & CEO, Penske Automotive Group

Conclusion

At Mercer Capital, we follow the auto industry closely in order to stay current with trends in the marketplace. These give insight into the market that may exist for a private dealership which informs our valuation engagements. To understand how the above themes may or may not impact your business, contact a professional at Mercer Capital to discuss your needs in confidence.

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Light Weight Vehicle Sales: Autos and Light Trucks (SAAR)

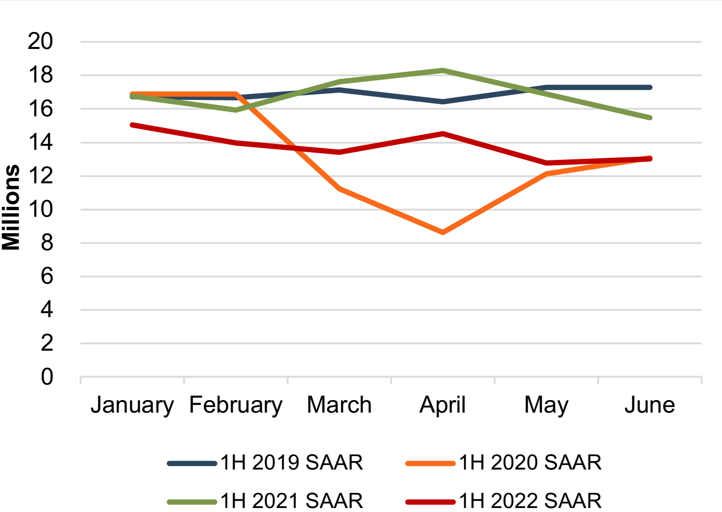
As of Mid-Year 2022

A Seasonally Adjusted Annual Rate (SAAR) is defined as a rate adjustment used for economic or business data, such as sales or employment figures that attempts to remove seasonal variations in the data. In the automotive space, it is understood to mean the number of light weight vehicles sales (autos and light trucks) sold in a given month, adjusted for seasonal factors and scaled up to a year's worth of sales based on that month.

SAAR, an oft quoted figure for auto dealers, stood at 13.0 million units in June 2022, down from 15.5 million units in June 2021. This was actually below SAAR in June 2020, as auto dealers ramped up sales after historic lows in April 2020 due to the COVID-19 pandemic. For auto dealers, supply chain constraints due to the lack of microchips have in some ways inhibited sales more than the pandemic did, with SAAR in the 13-15 million range for most of the past year. As seen in the chart "First Half SAAR 2019-2022," the red line for the most recent period is considerably below 2019 and 2021 levels.

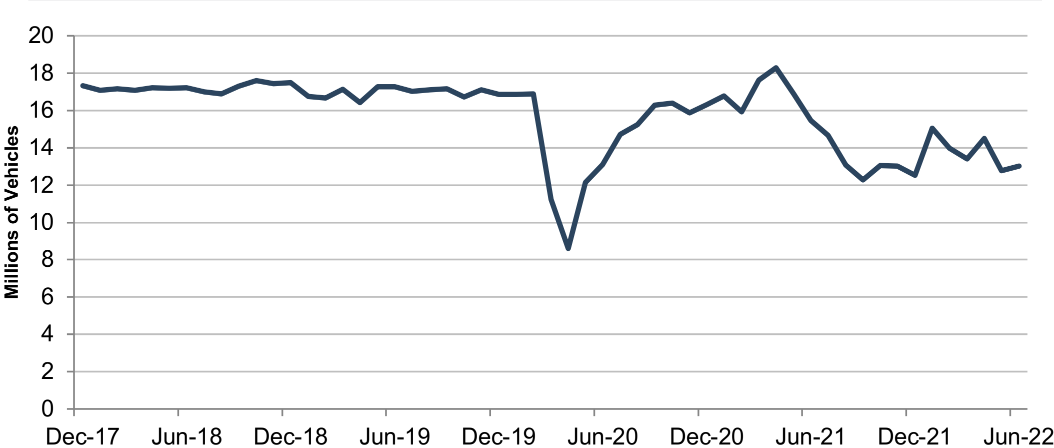
SAAR strives to adjust for seasonality, such as typically higher sales in December and March compared to lower sales in January and February. However, the chart "Light Weight Vehicle Sales," shows that the material decline in April 2020 due to COVID may obscure analysis going forward as 2021 and 2022 saw bumps in April as they were able to outperform this anomalous month.

First Half SAAR 2019-2022



Source: Federal Reserve Economic Data

Light Weight Vehicle Sales: Autos and Light Trucks, Seasonally Adjusted Annual Rate



Source: St. Louis Fed

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Blue Sky Multiples

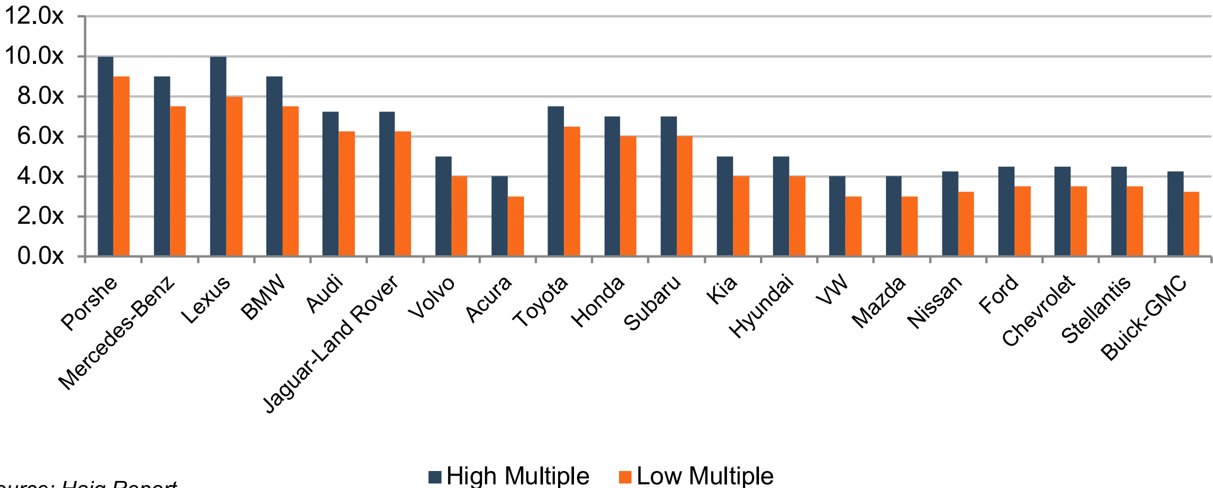
As of Mid-Year 2022

Blue sky multiples come from the Haig Report and are calculated as a multiple of adjusted pre-tax profits. The ranges are an expression of what buyers in a competitive situation will pay for the goodwill of dealerships. Dealerships that are underperforming or in desirable markets will have high multiples while those that are over-performing, are in less desirable markets, or have significant real-estate issues will have lower multiples. In some cases, only a franchise value range is reported, indicating underperforming brands that potentially have negative earnings for which a pre-tax multiple would not be meaningful.

Blue Sky multiples have been relatively stagnant since Q3 2020, with no brands seeing a decline in their multiple. Elevated earnings have led to higher values for dealerships even without significant increases in multiples, though this may be softening heading into the back half of 2022.

Generally, multiples are at or near their highest points in recent years. For example, all mid-line import brands are at their highest level since Haig began publishing multiples in 2014. On the other hand, Audi has fallen the farthest from its peak when it was one of the hottest brands in mid-2015 while Ford is the only other brand whose current multiple is at least 1.0x lower than its all-time high in early 2018.

New and Used Vehicles Sold and Gross Profit per Unit



Source: Haig Report

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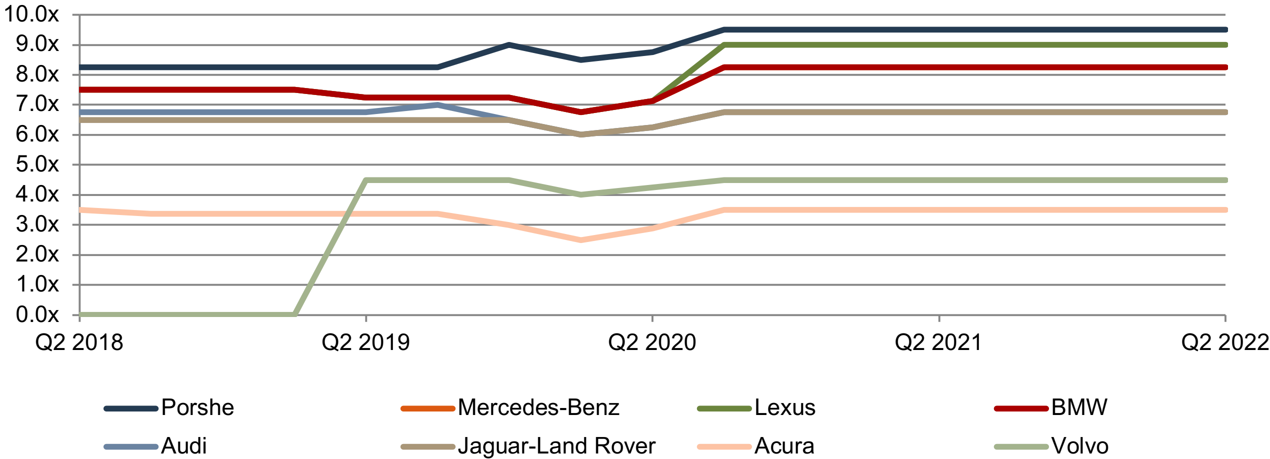
Blue Sky Multiples History

As of Mid-Year 2022

Luxury Blue Sky Multiples History

After three straight quarters of changes in 2020, not a single luxury dealership saw a change in its multiple range in the next seven quarters. However, after years of only reporting a value range due to a lack of profitability, Cadillac dealerships reported at a range of 3x-4x in Q4 2021. Similarly, Infiniti and Lincoln reported a multiple range of 3x-4x in the Q2 2022. Value ranges are used instead of multiples when many of the brands' dealers are not profitable, but with improved earnings performance industry-wide, Haig is now reporting a multiple range for every brand covered in its report for the first time since at least Diesel Gate in 2014. We note the 3x-4x range for Cadillac, Infiniti, and Lincoln matches the 3x-4x range of Acura dealerships, which have consistently reported a multiple range at the low end for luxury dealerships.

Luxury Blue Sky History



Source: Haig Partners

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Blue Sky Multiples History

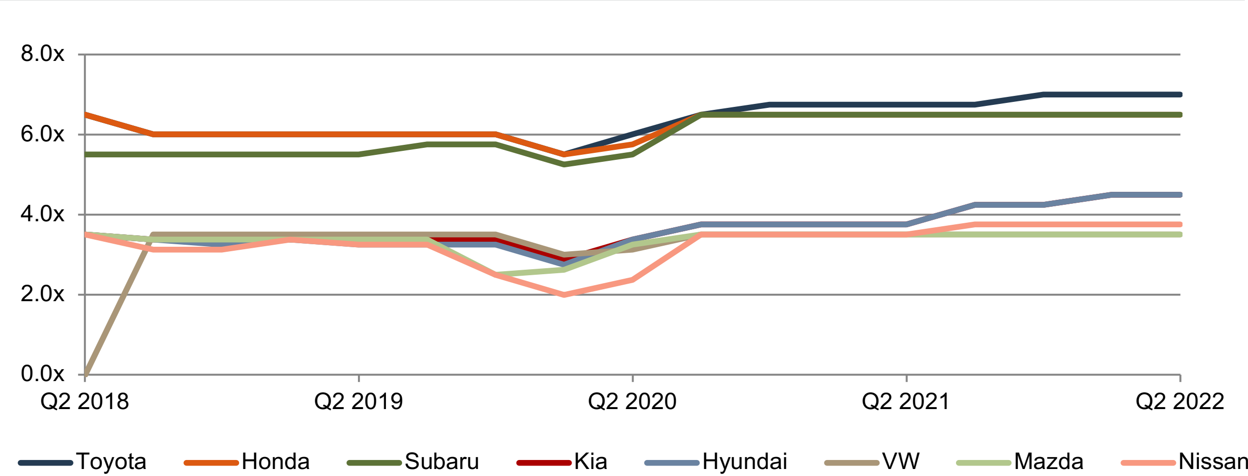
As of Mid-Year 2022

Mid-Line Blue Sky Multiples History

During the first half of 2022, Hyundai and Kia saw another 0.25x improvement in multiple to a range of 4x-5x, building on a 0.5x improvement in Q3 2021. There are now three distinct tiers of mid-line brands: Toyota paces the top group (followed by Honda and Subaru), Hyundai and Kia, despite improvements, are still 2.0x below the top three, followed by VW, Nissan, and Mazda, which are about 1.0x below Hyundai and Kia and in line with the lowest multiples of the luxury brands.

Toyota dealerships still fetch higher valuations than Audi and Jaguar-Land Rover dealerships. While they do not sell luxury vehicles, Toyotas are viewed as dependable vehicles. Potentially more important to dealers, Toyota has indicated it has no plans to replace dealerships with an agency model and is committed to a phased transition into EVs while also offering ICE vehicles and hybrids. Haig declared that Toyota might be the most desired brand in the industry. We find this interesting as Toyota dealerships remain a bargain in terms of their Blue Sky multiple range as compared to the top-of-the-line luxury dealerships. Desirability may also be factoring in cost, and the supply of luxury dealerships for sale may have an impact on the higher multiples for Porsche, Lexus, etc., particularly considering Toyota Motor Corporation owns Lexus.

Mid-line Blue Sky Multiples History



Source: Haig Partners

Blue Sky Multiples History

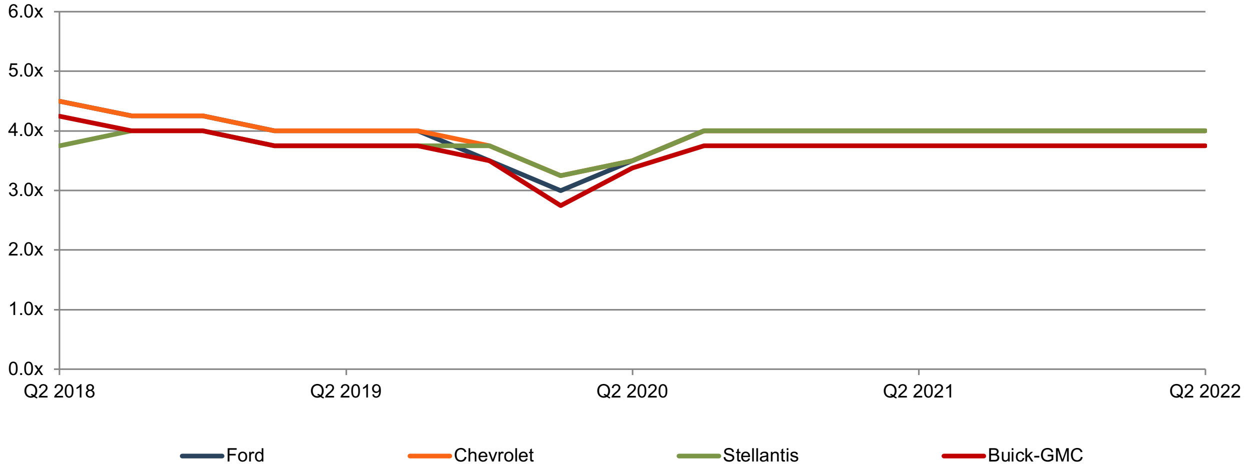
As of Mid-Year 2022

Domestic Blue Sky Multiples History

Domestic franchise multiples have not changed since Q3 2020. With the rise of Hyundai and Kia's multiples over the past year, domestic brands' multiples are now generally in between the second and third tier of mid-line imports, where they once held a slight advantage over some of those brands. One would think that supply chain constraints would more negatively impact import brands than their domestic counterparts. However, the past two years have demonstrated that even domestic brands rely heavily on the global supply chain for their inputs, particularly microchips.

In the last four years, domestic brands Ford, Chevrolet and Buick-GMC are the only brands across all of the published Haig multiples that have decreased. In Q2 2018, these brands' multiples were half a turn higher than they are in Q2 2022. Stellantis actually increased over that same period but only by 0.25x.

It is important to note that the published Blue Sky multiple ranges, while certainly reasonable, do not imply that dealerships are actually transacting at these multiples. With the performance of most dealerships remaining elevated, owners on the lower end of Blue Sky multiples are less likely to transact when the payback period on an investment is so short (unless they need liquidity or are approaching retirement without an identified succession plan).



Source: Haig Partners

Guidline Public Company Analysis

As of Mid-Year 2022

Blue Sky Multiples

While the public auto dealers are too diversified to analyze Blue Sky multiples at the brand-level, implied Blue Sky multiples are still illustrative of how public market investors are valuing auto dealership groups.

As seen in the table below, LTM Blue Sky multiples for the public auto dealers is low, at 3.5x. Using Haig's 3-year average methodology, this figure jumps to 6.76x, which supports Haig's view of multiples, which was 5.33x as of Q2 2022. This difference between LTM and ongoing multiples demonstrates the considerably heightened level of earnings, which implies earnings are nearly double ongoing expectations as the 3.5x multiple is close to half of 6.76x. It is also notable that FWD multiples are nearly identical to LTM multiples. This suggests that research analysts are not anticipating a near-term decline in earnings in the near future, at least as of the quarter end.

Implied Blue Sky Multiples	Asbury	AutoNation	Group 1	Lithia	Penske	Sonic	Average
Stock Price	$169.34	$111.76	$169.80	$274.81	$104.69	$36.63	
less: Tang. Book Value per Share	$51.86	($6.23)	$4.35	($73.11)	($18.36)	($6.62)	
Implied Blue Sky per Share	$221.20	$105.53	$174.15	$201.70	$86.33	$30.01	
LTM Pre-Tax Income per Share	$44.72	$31.03	$55.12	$59.35	$24.08	$11.89	
LTM Q2 2022 Blue Sky Multiple	4.95x	3.40x	3.16x	3.40x	3.59x	2.52x	3.50x
FWD Pre-Tax Income per Share	$44.47	$31.25	$54.12	$61.33	$22.13	$13.47	
FWD Q2 2022 Blue Sky Multiple	4.97x	3.38x	3.22x	3.29x	3.90x	2.23x	3.50x
Haig's 3-Year Avg. Pre-Tax Income per Share	$24.98	$14.49	$29.31	$34.17	$13.35	$4.91	
Haig Blue Sky Multiple	8.86x	7.28x	5.94x	5.90x	6.47x	6.11x	6.76x

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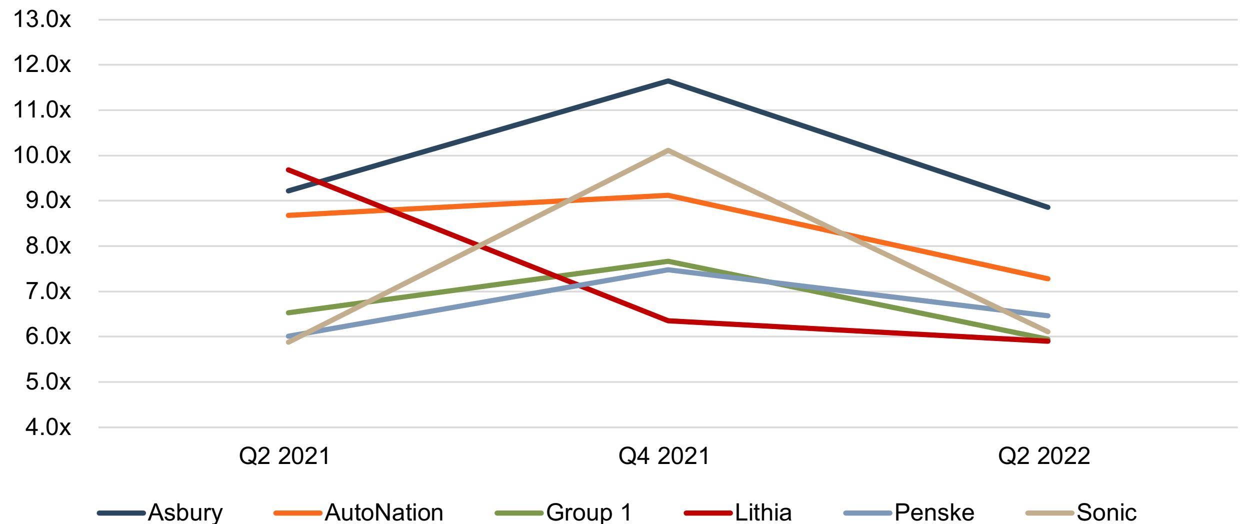
Guidline Public Company Analysis (cont.)

As of Mid-Year 2022

Blue Sky Multiples (cont.)

As seen in the graph below, public multiples have generally declined over the past year, though most actually increased at year-end. Lithia's shift in multiple is the most notable going from the highest to the lowest in the past year. Otherwise, investors do not appear to have materially "re-valued" the public auto dealers, at least when compared on a relative basis (i.e., Asbury continues to have one of the highest multiples while Group 1 is near the bottom).

Haig Blue Sky Multiple



Source: Haig Partners

Guidline Public Company Analysis

(cont.)

As of Mid-Year 2022

Market Capitalization, Revenue, and Dealership Count

Public auto dealers saw their market caps decline by an average of 14.5% in the first half of 2022, which compares favorably to a 20.6% decline in the S&P 500 index for the period. Equity values were also lower over the past twelve months, down 2.7% for auto dealers compared to 11.9% for the broader market. While all dealers saw their stock prices decline in the past 6 months, performance was much more disparate over the past year with Asbury and Penske up considerably while AutoNation, Lithia, and Sonic fell about 15%-23%.

Lithia's revenue has grown the most due to their aggressive growth strategy, though the decline in stock price indicates investors are either revaluing this growth or are concerned by the prices Lithia may have paid for these acquisitions. Lithia has added 33 dealerships in the past 12 months. This was outpaced only by Asbury and it's acquisition of Larry H. Miller dealerships in the western U.S., which is anticipated to nearly double revenues on an ongoing basis.

Public Auto Dealers	Ticker	Market Capitalization	6 Mo. Change in Market Cap	12 Mo. Change in Market Cap	LTM Revenue	6 Mo. Change in Revenue	12 Mo. Change in Revenue	Dealership Count	12 Mo. Change in Dealerships
Asbury Automotive Group, Inc.	ABG	$3,748	-6.2%	13.1%	$12,923	31.4%	45.9%	148	62.6%
AutoNation, Inc.	AN	6,518	-14.9%	-14.6%	26,584	2.9%	10.4%	247	8.3%
Group 1 Automotive, Inc.	GPI	2,729	-20.0%	0.7%	14,892	10.5%	20.5%	201	11.0%
Lithia Motors, Inc.	LAD	7,951	-11.6%	-23.4%	26,425	15.7%	47.5%	292	12.7%
Penske Automotive Group, Inc.	PAG	7,945	-5.4%	30.2%	26,676	4.4%	8.7%	332	8.9%
Sonic Automotive, Inc.	SAH	1,449	-29.0%	-22.1%	13,497	8.9%	17.5%	111	32.1%
Average		**$5,057**	**-14.5%**	**-2.7%**	**$20,166**	**12.3%**	**25.1%**	**222**	**22.6%**
Median		**$5,133**	**-13.2%**	**-6.9%**	**$20,658**	**9.7%**	**19.0%**	**224**	**11.9%**

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Guidline Public Company Analysis

(cont.)

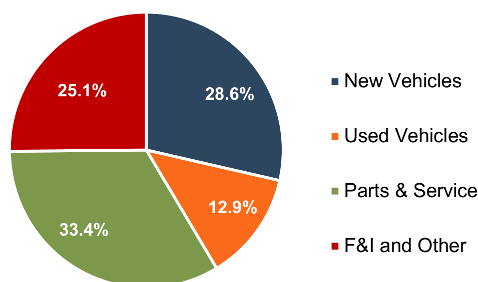
As of Mid-Year 2022

Gross Profit by Segment

Historically, parts and service departments have made the largest contribution to gross profit for the publicly traded dealers. As seen in the line graph below, this has modestly declined recently as heightened profitability in the variables sales segments has increased. On average, gross profit from fixed operations increased 28.7% in the first half of 2022 compared to the prior year period, while new vehicle gross profit has advanced by 64.3%. Used vehicle gross profit has grown the least over this period at 11.9%, as used vehicle gross profit has slowed.

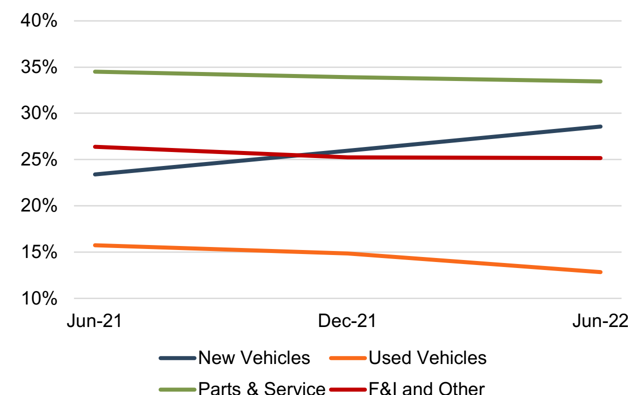
Public Auto Dealers	New Vehicles	Used Vehicles	Parts & Service	F&I and Other	Total
Asbury Automotive Group, Inc.	22.7%	15.8%	39.3%	22.2%	100.0%
AutoNation, Inc.	21.6%	14.5%	34.8%	29.0%	100.0%
Group 1 Automotive, Inc.	22.6%	15.9%	36.3%	25.2%	100.0%
Lithia Motors, Inc.	25.8%	21.3%	27.2%	25.7%	100.0%
Penske Automotive Group, Inc	27.1%	19.0%	33.0%	20.8%	100.0%
Sonic Automotive, Inc.	20.6%	7.8%	36.3%	35.3%	100.0%
Average	**23.4%**	**15.7%**	**34.5%**	**26.4%**	**100.0%**

Average Gross Profit by Segment



Source: S&P Capital IQ Pro

Average Gross Profit by Segment



Source: S&P Capital IQ Pro

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Auto Dealer Industry

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
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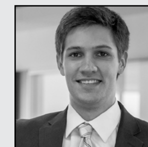

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