VALUE FOCUS

Auto Dealer Industry

Issue No. 7 | Data as of Year End 2020

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**.

Seven Factors of a Highly Effective Buy-Sell Agreement for Auto Dealerships

A Roadmap to the Valuation Process

A few of our recent auto dealership valuation engagements have involved disagreements among family members and the next generation or what might otherwise be termed a business divorce. Inevitably, one of the first questions I always ask: Is there a Buy-Sell Agreement or Governance Document that will provide a roadmap into the valuation of the business and the respective subject interests? Often the answer is "I'm not sure, I don't know, or maybe but we haven't reviewed it in some time."

We've also encountered plenty of examples where these documents exist, but they are either poorly written, do not contain the necessary information, or have not been contemplated in many years since the drafting of the document. In **Stephen Covey's popular management book**, he discussed the seven habits of highly effective people. In this article, we will cover seven factors of a highly effective buy-sell agreement for auto dealerships and also touch on several other considerations.

1. Standard of Value

The standard of value establishes the parameters for how the auto dealership will be valued. It should be clearly defined and give clear indications for how the participants in a hypothetical transaction should be viewed: buyer, seller, motivations, knowledge of facts, etc. The most common standard of value is fair market value and is generally defined as a hypothetical buyer and a hypothetical seller both having reasonable knowledge of the business and all relevant factors and neither being under any compulsion to buy or sell. The other most common standard of value in Buy-Sell Agreements is fair value. Simply put, fair value is fair market value without consideration of any applicable discounts for lack of control and lack of marketability for the subject interest. Fair value is often used in legal proceedings. The difference between these two standards of value and the lack of clarity in defining which standard is governed by a Company's Buy-Sell Agreement is often the impetus to litigation.

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2. Level of Value

Level of value is a valuation concept describing the differences between various "levels" of a company's value. Levels of value can include financial control, strategic control, marketable minority interest, and non-marketable minority interest. Each level has a distinct difference in the amount of control one can exhibit over the operations of a business and/or their ability to sell an interest in that business. For the layperson, the levels of value ultimately dictate whether premiums or discounts would be applied to the subject interest being valued.

3. Define Triggering Events

If the goal of a Buy-Sell Agreement or Governance Document is to provide a roadmap for the valuation, then it's important for these documents to define the events that will be governed under their parameters. These events are often referred to as Triggering Events and can include the death of an owner, termination of an owner, divorce, change of control, etc. By defining the Triggering Events, it will be clear when the document will be enacted and enforced and when it will not apply. For example, selling or gifting a minority interest in the business to future generations is not likely to be a triggering event in this context and almost certainly would not be valued at anything besides the nonmarketable minority level of value.

These events can also have unique ramifications to auto dealerships. For example, each franchised dealer has a dealer principal that has to be approved by the manufacturer. The death or a divorce of a dealer principal can also pose challenges as the transferability of that interest and title of dealer principal is not guaranteed and cannot occur without approval from the manufacturer.

4. Avoid Formula Pricing

Often these documents contain a formula or a methodology to value the business. The formula might consist of the applicable financial information to consider and the multiple to apply to those metrics to determine the value. At the time of the drafting of the Buy-Sell, these formulas might establish the shareholders perceived value of the business. If considerable time has passed between the drafting of the document and the Triggering Event, these formulas and concluded values could be stale and outdated.

As we've previously discussed in this space, the auto dealership industry is unique from a valuation perspective. Traditional formulas such as EBITDA multiples often utilized in other industries are not as informative in this industry. The drafting attorney may not be as familiar with the nuances of auto dealership valuation. Even if an industry-appropriate metric,

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such as a Blue Sky multiple or formula is used, it is likely be dated in a short period of time. National auto brokers (**Haig Partners** and **Kerrigan Advisors**) publish and update these Blue Sky multiples by manufacturer quarterly. As we've seen during the COVID-19 pandemic, operational conditions and perceived franchise values can change both quarterly and over a longer time horizon. Additionally, dealerships could evolve over time and acquire or divest of different franchises that could drastically change their operations and perceived value.

Finally, what adjustments are to be considered? Even if a Buy-Sell Agreement has language providing for a multiple to be updated with the current market environment, significant one-time or non-recurring income or expense items can inflate or depress value.

5. Specify Valuation Date

The Buy-Sell Agreement should explicitly define the date to be used for the valuation. Typically, the date of valuation would be at or near the Triggering Event depending on its proximity to the timing and availability of current and reliable financial information. A proper valuation should consider what is reasonably known or knowable as of the date of valuation. Any ambiguity in defining the valuation date or the financial information to be used could have a significant impact on value. Since franchised auto dealers must submit monthly financial statements to the manufacturer, an appropriate valuation date might be set to be the month-end prior to the Triggering Event.

6. Defining Appraiser Requirements

Who should perform the valuation? Often Buy-Sell Agreements will utilize language such as a "qualified appraiser" and may even include certain valuation credentials such as an Accredited Senior Appraiser (ASA), someone who is Accredited in Business Valuation (ABV), or a Certified Valuation Analyst (CVA) from national valuation accrediting organizations. Since the auto dealership industry is so unique, these credentials may not be enough. Should your Buy-Sell Agreement also require that the appraiser have specific industry experience? Finally, independence is key. We recommend selecting a third-party valuation firm with experience in valuing auto dealerships so that the appraiser will be qualified and unbiased.

7. Make it a Living Document

How often does a Company have a Buy-Sell Agreement or governance document drafted only to be placed in an electronic file, a desk drawer, or a file cabinet and never reviewed or contemplated again? The value of an effective Buy-Sell Agreement is to provide a roadmap for how to value the dealership at a Triggering Event. If the document was never used since drafting, can it be reliable? Effective Buy-Sell Agreements are not only drafted, but they are utilized. Some require ongoing valuations

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A Roadmap to the Valuation Process

(continued)

at annual anniversaries or other timeframes to provide the owners with a value indication that could be used for strategic planning or contemplation of an upcoming Triggering Event. If the document didn't clearly contain the items in this post and was never used since drafting, it could create confusion leading to litigation or the Buy-Sell Agreement could be ignored in an eventual litigation. Frequent use or at least consideration of the terms considered in the document are likely to be much more relevant in a litigation context.

Conclusions and Other Considerations

An effective Buy-Sell Agreement can provide a roadmap to defining the valuation process through many challenging events during the lifetime of an auto dealership. As we've discussed, the document should contain and clearly define these seven elements, among others, to accomplish that goal.

Other considerations to contemplate are the premise of value, funding mechanisms for repurchase, and managing expectations. The premise of value will establish whether to determine the value of the dealership if it continues as a going-concern business as opposed to liquidation. Funding mechanisms and repurchase requirements can also dictate the mechanical treatment of certain assumptions in the valuation such as the impact of recognizing life insurance proceeds at the death of an owner to establishing a market for the subject interest that could possibly impact the applicable discount for lack of marketability.

Does your Auto Dealership have a Buy-Sell Agreement or Governance Document? When was it drafted? Who drafted it? Does it contain and discuss these seven key items? If it contains formula pricing, would buyers and sellers find the methodology employed reasonable today?

To discuss the impact of your Buy-Sell Agreement, assist you and your attorney in drafting an effective Buy-Sell Agreement, or determine the valuation of your auto dealership at a Triggering Event, contact a professional at Mercer Capital today.

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The Chip Shortage Is Making It Feel Like 2020 All Over Again

Last year, many of our **blog posts** touched on the subject of inventory shortages due to plant closures from the pandemic. However, after stay-at-home orders were relaxed and plants got up and running again, there were high hopes among the major public dealers that inventory levels would return to pre-COVID levels in 2021 and dealerships could meet consumer pent up demand. However, manufacturers are facing a new obstacle on the production line that is a threat to reaching these inventory goals. All over the world, automakers (and other industries) are grappling with a shortage of computer chips.

In this article, we discuss the necessity of chips in the auto making process, how the chip shortage came to fruition, how it is affecting the industry, and what all this might mean for auto dealers going forward.

Small But Mighty

When considering all of the different digital products that you might use on a day to day basis, there is likely one specific thing that they all have in common: computer chips. While cars might not be the first thing to pop in your head when you're thinking about digital technologies, they also rely on them for many different functions.

As OEMs continue to innovate and more features become standard, consumers have benefitted from an enhanced experience while vehicle prices have increased. These advances have also increased the reliance on semiconductors, which have become a crucial part of the supply chain. Car companies can use them to power the **modern-day tech-**

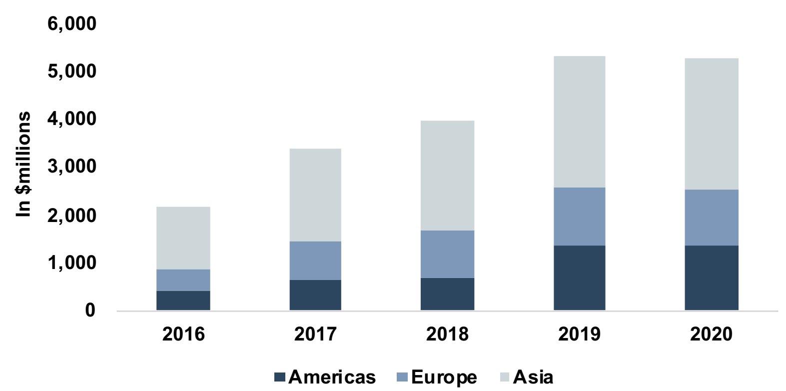
The Chip Shortage Is Making It Feel Like 2020 All Over Again

(continued)

nology in their vehicles, such as the engine, Bluetooth capabilities, seat systems, collision and blind-spot detection, transmissions, Wi-Fi, and video displays.

As **Kristin Dziczek**, a senior industry analyst with the *Center for Automotive Research (CAR)* notes, "Today's automobiles use a huge number of computer chips, chips in the engine, chips in the seat, chips in everything, but they're in tight supply right now." A mainstream car has more than 100 microprocessors.

Sales of Microchip Technology by Region



How It Started

Like many other production struggles that have occurred in the past year, the COVID-19 pandemic is at the root of the shortage of chips. With the new normal of being indoors, demand for electronics increased substantially, boosting demand for microchips. Xbox and Playstation also released their l**atest consoles in mid-November**. The last consoles brought to market by these companies was in 2013, so the timing of this launch exacerbated these issues.

While demand for electronics was increasing at the beginning of the pandemic, demand for cars had waned, and thus, automakers like General Motors, Toyota, and Subaru, were forced to close factories at the onset of the pandemic. In accordance, this caused overly conservative demand estimates to be made. However, once the plants reopened, demand was much higher than anticipated, and the chips necessary to fulfill the demand just were not there.

Chipmakers tend to favor consumer electronics because their orders are larger than those of automakers. The annual smartphone market is **more than a billion** devices compared with fewer than 100 million cars. Automaking is also a lower-margin business, leaving manufacturers unwilling to bid up chip prices to avoid risking profitability. **Automakers in China** were the first to feel the impacts of the shortage, primarily due to it being the world's biggest auto market recovering from the pandemic, but now the shortage has spread to auto manufacturers across the globe.

The Chip Shortage Is Making It Feel Like 2020 All Over Again

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Current Impacts

Major auto manufacturers are already starting to react to the chip shortage. **Ford** is the latest, cutting production of its top money maker, the F-150 pickup truck, due to the chip shortages. The impact could be significant, as the Ford CFO John Lawler notes, "Right now, estimates from [chip] suppliers could suggest losing 10% to 20% of our planned first-quarter production." This could mean a loss of profit of $1 to $2.5 billion in 2021. Ford is proactively trying to mitigate risk in other parts of their vehicles subject to supply chain disruption, and has hinted that they might be investing in battery production to avoid a similar issue on that front.

Ford is not alone in production cuts though, as it joins General Motors, Nissan, Volkswagen, Toyota, Mazda, and Subaru in cutting output due to the semiconductor shortage. With not enough chips in supply, the automaking industry stands to lose **$61 billion** in 2021, as reported by consulting firm Alix Partners as *Bloomberg* reported.

As of right now, there is no clear answer for when the chip shortage will be alleviated. **Macquarie Capital** expects auto production to be affected until mid-2021, as chipmakers up their production, while data firm *HIS Markit* said the shortage could last until the third quarter this year. As the shortage has worsened in the past week, 15 senators have asked President Joe Biden to secure the funding necessary to implement clauses related to chips in the National Defense Authorization Act, in the hopes it could spur production in the U.S.

Potential Impacts for Auto Dealers

Overall dealership supply is most likely going to be impacted by the chip shortage, and for shoppers who have the money to buy new cars and are expecting deals, they may be disappointed by the selection available. This is a major blow to auto dealers, especially after the public companies on their last earnings call were anticipating inventories to stabilize in 2021. Stay tuned for our upcoming earnings call blog post to hear what public dealers prospects on the matter.

All else equal, shortages could squeeze profits for OEMs if they are all vying for the same limited amount of chips. These costs would likely trickle down to dealers who would attempt to pass them on to consumers. However, it is a bit too early to say for certain what the overall impact will be on dealership profitability. A lot of it may depend on how significant the disruption ends up being and how long until things normalize once again.

The Chip Shortage Is Making It Feel Like 2020 All Over Again

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Regardless, it is not the optimistic news that many were hoping to kick off 2021 and signals continuing struggles as the industry tries to shake off the effects of this pandemic. Though the current circumstances are uncertain, the COVID-19 vaccine offers some hope that things will begin to stabilize soon. The current microchip shortage may not be ideal in the current circumstances for inventory levels and dealership profitability, but the impacts will not last forever.

If you are interested in learning more about how this may impact the value of your dealership, feel free to reach out to any of us on the auto dealer team. We hope everyone is continuing to stay healthy during this time!

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Average Annual Auto Dealer Profile

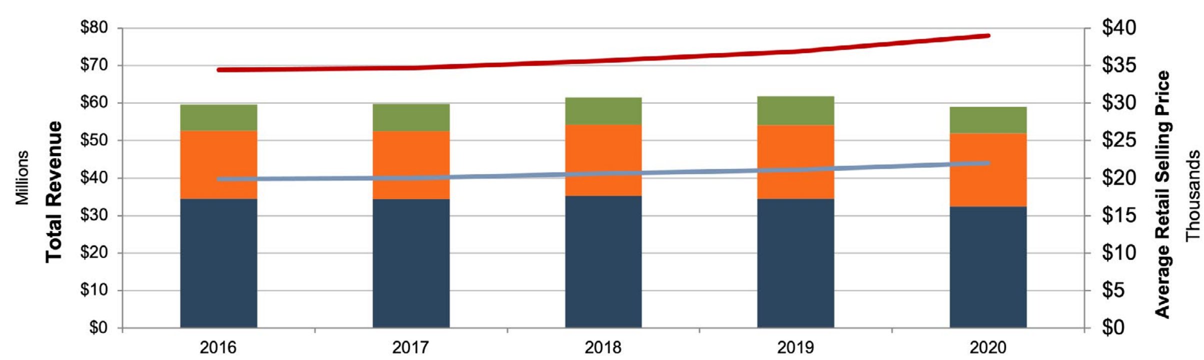
As of Year-End 2020

Average total sales per dealership decreased 4.2% in 2020 compared to 2019, driven by declines across the board as a consequence of the economic fallout from the Covid-19 pandemic and stay at home orders. Sales for new vehicles and service and parts each declined about 6-9%. Fewer miles driven led to a decline in revenue from servicing vehicles, while supply chain issues have materially impacted volumes, lowering new vehicle revenues. Used vehicle sales on the other hand have declined only 0.8%. For numerous reasons, consumers have shifted vehicles purchases from new to used, causing this segment's revenue to decline the least in 2020.

New vehicle revenue continues to make up more than half of dealership revenues at 55% in 2020, down from 56% last year. After successive years of increases, the sharp decline in sales in 2020 has pushed average dealership revenue to below 2016 levels, driven largely by the new vehicle segment. Used vehicle and service and parts revenues have each increased, at a compound annual growth rate of 1.8% and 0.3%, respectively. Still, a 1.6% compound annual decline on the new vehicle department has caused total revenues to decline 0.3% annually from 2016 to 2020.

In 2020, the average retail selling price of new cars and trucks increased 5.8%, while used vehicle prices increased 4.4%. Without adjusting for number of dealerships, the average number of new vehicles retailed for an average dealership declined 10.7% in 2020, while used vehicles retailed declined only 4.4%. With declining volumes but strong gross profits, GPUs improved 21.6% to $2,444 per new vehicle retailed and 12.6% to $2,675 per used vehicle retailed. Incentives at the beginning of the pandemic and near zero interest rates have contributed to these boosts in price, as have inventory constraints from manufacturing slowdowns. The gap in average selling price (ASP) between new and used cars increased as new cars retail for an average of just below $39 thousand while used cars on average sell for just over $22 thousand.

Total Sales and ASP for Average Light Vehicle Dealers



Source: NADA

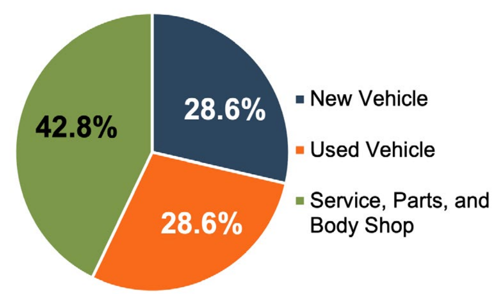
Domestic Dealerships

As of Year-End 2020

Gross Profit Trends

Gross profit increased 2.9% in 2020 for domestic dealerships, above the compound annual growth rate of 2.3% since 2016. Domestic dealerships continue to earn the lowest gross profit compared to import, luxury, and mass market dealerships. Notably, almost 43% of gross profit in 2020 came from service and parts departments for domestic dealerships, which was the lowest in the past five years and is attributable to lower miles driven during the pandemic. The remainder of gross profit for average domestic dealerships is relatively evenly split between new and used vehicles. Since 2017, the contribution from used vehicle departments for domestic dealerships increased from 24.4% to 28.6%.

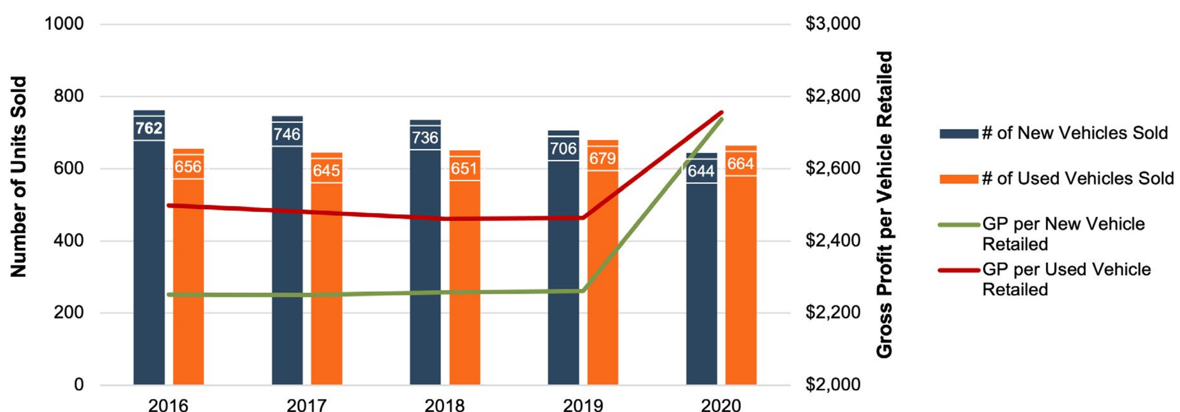
Gross Profit by Segment



Source: NADA

The number of new cars retailed by average domestic dealerships dropped 8.9% in 2020 which has declined in each year since 2016. In 2020, domestic dealerships sold more used vehicles than new vehicles, the first such instance for any type of dealership in the past five years. Gross profit per new vehicle retailed increased 21.0% in 2020 to a recent high of $2,737, reflecting increased new vehicle prices due to lower volumes. While gross profit per used vehicle has generally declined since 2016, this figure increased 11.9% to $2,756 in 2020. While this is partially due to declining volumes, the 2.2% decline in used volumes was far less than the 8.8% decline for new vehicle volumes. Average retail selling prices increased 5.8% and 4.4% for new and used vehicles, respectively, and gross profit margins improved for new (6.3%) and used (12.1%) vehicles indicating dealers have largely passed on increased costs to consumers.

New and Used Vehicles Sold and Gross Profit per Unit



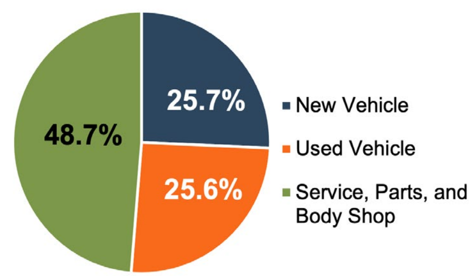
Source: NADA

Import Dealerships

As of Year-End 2020

Gross Profit Trends

Gross Profit by Segment

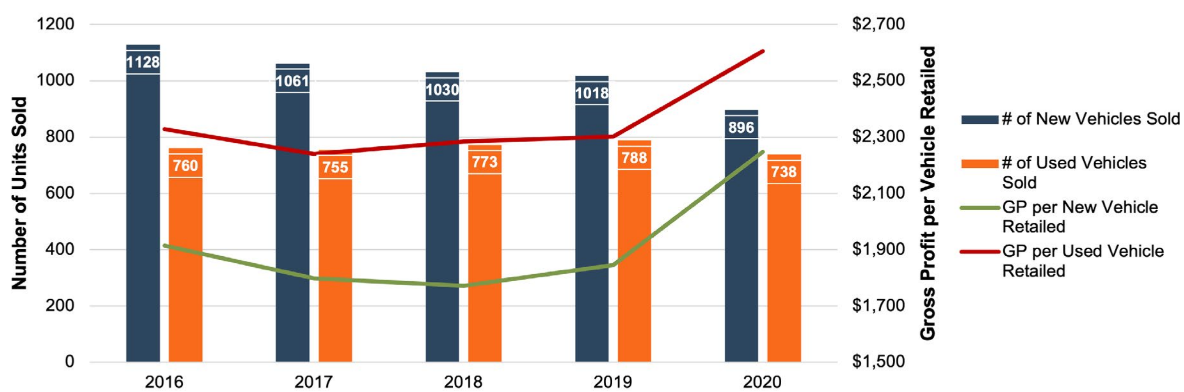


Source: NADA

Gross profit increased 1.1% in 2020 for import dealerships, led by used vehicle department growth which contributed 25.6% of gross profit, the highest this figure has been in the past five years. About 48.7% of gross profit in 2020 came from service and parts departments for import dealerships, a notable decline from 52.4% in 2019. Service and parts departments have considerably higher margins, which allows them to make up a significant portion of gross profit without being a large portion of dealership revenues (only 12.6% of sales). However, service and parts contribution to gross profit has declined to the lowest levels since 2016, most likely a factor of the pandemic as drivers spent less time on the road and thus, less wear-and-tear than needs to be addressed. The decline in service and parts contribution was picked up by new and used car contributions which increased to a total of 51.3% compared to 47.6% in 2019. Despite headwinds, new vehicle departments for import dealers contributed slightly more than used vehicles in 2020, a modest reversal from 2019.

New and used vehicle sales volumes for import dealerships declined in 2020 to five-year lows, down 12.0% and 6.3%, respectively from 2019. Though sales were down, gross profit per retailed vehicle (both new and used) increased in a similar fashion to domestic dealerships, with lower volumes sold but increased vehicle prices and gross margins. Gross profit per new and used vehicles retailed are up 4.1% and 2.8%, respectively. GPUs were at the highest level seen in the past five years for new and used vehicles.

New and Used Vehicles Sold and Gross Profit per Unit



Source: NADA

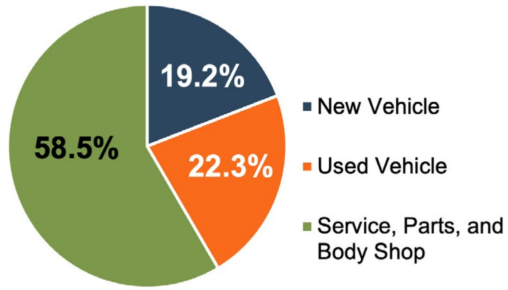
Luxury Dealerships

As of Year-End 2020

Gross Profit Trends

Average luxury dealership gross profit increased 9.8% in 2020 to $10.4 million, the highest figure in the past five years. This is a notable reversal from the first half of 2020; gross profit in the first half of 2020 was 19.4% below the prior year period. Gross profit margin for new and used vehicles in 2020 was 4.6% and 9.6%, respectively. New vehicle gross margins improved to the highest since 2016, while used gross margins were the highest in the past five years for luxury dealerships. However, luxury gross margins continue to be lower than other types of dealerships. Due to higher ASPs, luxury dealerships consistently earn the highest total gross profit figures and highest GPUs but lowest gross margins (because cost of goods sold is larger percentage of revenue). Luxury dealerships receive the highest percentage of their gross profit from service and parts departments as consumers are more likely to return to a dealership for servicing when they purchase a more expensive vehicle. In 2020, service and parts contribution to gross profit of 58.5%, the lowest since 2016, consistent with declines seen across all types of dealerships. Used vehicles increased to contribute 22.3% of gross profit in 2020 for luxury dealerships, the highest since 19.7% in 2018.

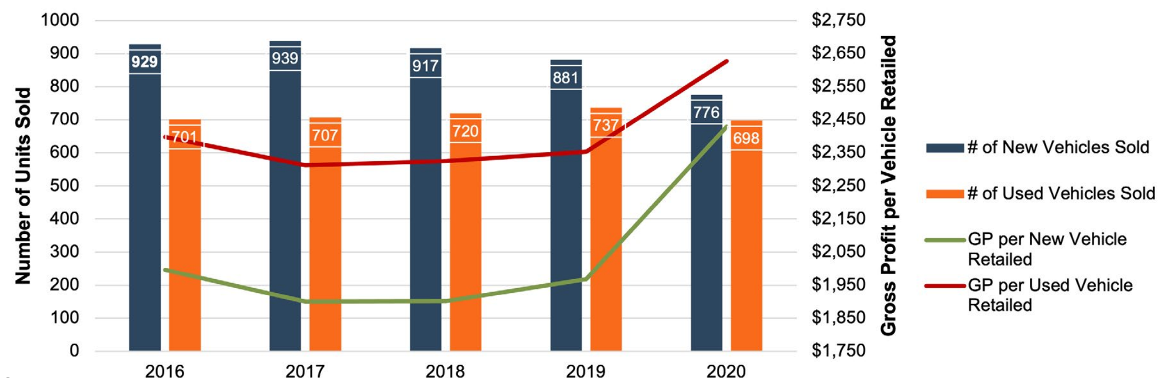
Gross Profit by Segment



Source: NADA

The number of new cars and trucks retailed by the average luxury dealership increased in 2020, while these figures declined for all other types of dealerships. Despite increasing volumes, GPUs improved in 2020. Gross profit per used vehicle retailed increased 19.0% to just over $3,000 per unit. Similarly, gross profit per new vehicle retailed increased 7.2% to $2,554. Despite this increase, luxury GPUs for new vehicles was usurped by that of domestic dealerships, which increased 21.1% to $2,737 per vehicle. This was the first time in the past five years that a non-luxury dealership had the highest GPU for either new or used vehicles.

New and Used Vehicles Sold and Gross Profit per Unit



Source: NADA

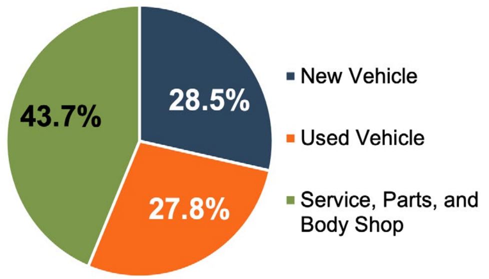
Mass Market Dealerships

As of Year-End 2020

Gross Profit Trends

Gross profit increased 0.5% in 2020 for mass market dealerships to a recent high of nearly $6.8 million. Like most other types of dealerships, approximately half of gross profit is derived from the service and parts departments, which declined in 2020 due to fewer vehicular miles traveled. Filling in the gap left by fixed operations, gross profit from new and used vehicle departments for mass market dealerships each increased by at least 2.0%, from 25.7% to 28.5% (new vehicle department) and 25.8% to 27.8% (used). While new vehicles had a larger increase in contribution in 2020, used vehicle gross profit contributions of 27.8% was the highest over the five-year period. This further demonstrates the increase in used vehicle activity in 2020.

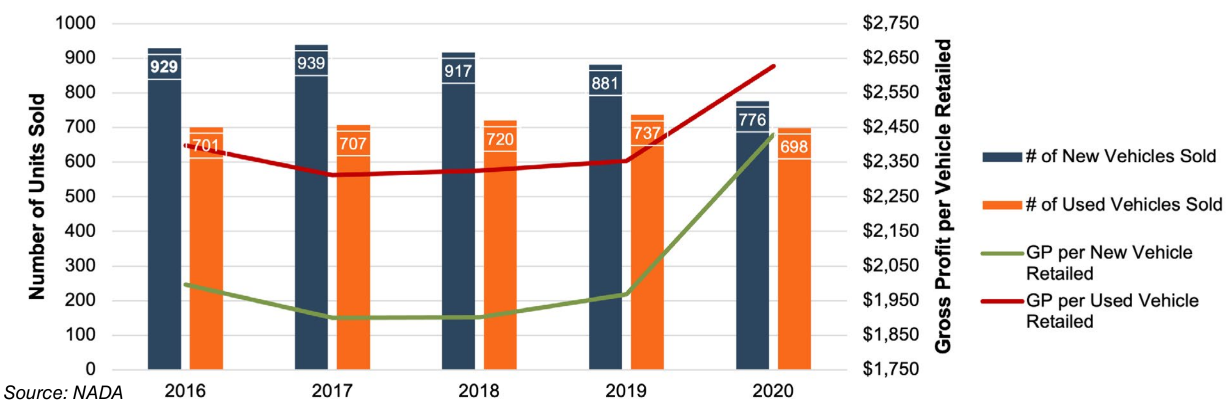
Gross Profit by Segment



Source: NADA

Since 2016, new vehicles retailed by mass market dealerships have declined at a compound annual rate of 4.4% to 776 vehicles. In this time, used vehicle volumes were essentially flat. GPU for new vehicles retailed increased to $2,429 due to declining volumes and increasing profitability, as the gross margin for new vehicles in 2020 represented a recent high of 6.6% of new vehicle sales. Used vehicle GPUs have consistently been within $2,300 to $2,400 in 2016 to 2019 for mass market dealerships. In 2020, this figure improved to $2,628, 11.6% higher than 2019. Used vehicle gross margins for mass market dealerships similarly improved to 12.7% of used vehicle sales, the highest of any type of dealership. New vehicle GPUs also narrowed the gap for used vehicle GPUs. Mass market dealers historically have received approximately $400 more gross profit for a used vehicle than a new vehicle. This difference declined to about $200 in 2020 as constrained supply for new vehicles raised per unit profitability.

New and Used Vehicles Sold and Gross Profit per Unit



Source: NADA

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

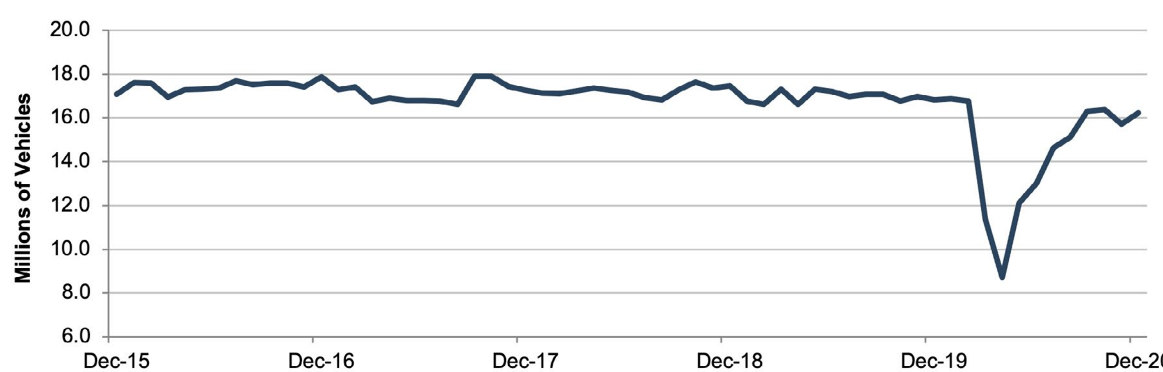
As of Year-End 2020

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 16.2 million in December 2020. This was below the 16.8 million observed in December 2019, though an improvement from the 13.0 million in June 2020. In April 2020, SAAR dropped significantly below historical levels due to the COVID-19 pandemic. Compared to 2019, seasonally adjusted volumes in that month were only 53% of the prior year results. From April to October, SAAR recovered as a percentage of the prior year period to 98%. This figure has been above 93% since September 2020. While volumes have rebounded, supply constraints related to the restrictions on OEM production has played a role in lower volumes that the prior year periods.

SAAR continues to be below pre-pandemic levels, with February 2021 volumes down 6.6% from the prior year period as global semiconductor microchip shortages from manufacturers further hamper production levels. According to NADA, North American production losses in the first quarter of 2021 are estimated at 250,000. For reference, 250,000 represents 1.6% of the February 2021 annualized 15.7 million figure. March 2021 levels and beyond are anticipated to considerably outpace their prior year figure as economic recovery from the pandemic is expected to continue.

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



Source: St. Louis Fed

Public Auto Dealers

As of Year-End 2020

Public auto dealers are some of the largest franchised dealers in terms of number of dealerships. Penske remains the largest auto group with over 300 locations, over half of which are located outside the U.S. Despite its high profile Park Place transaction, Asbury's dealership count only increased by 3 as it divested certain dealerships to comport with its shift towards luxury. Lithia Motors Inc. added 21 locations in 2020 towards their stated goal of $50 billion in revenue by 2025. Based on 2020 revenues, top line growth will need to grow at 13.8% over the next five years, which will require more acquisitions. Due to its 2020 acquisitions, Lithia was the only large public new vehicle auto dealer to have positive revenue growth, reporting an increase of 3.6%. By dealership count, Lithia has distanced itself from Group 1, with the gap between them equaling the gap between Lithia and AutoNation. Penske's revenue declined the most at 11.8%, though it has significant other activities (retail commercial truck dealerships and commercial vehicle distribution and other) which contributed to the decline. As a result, AutoNation has narrowed the gap in terms of the top spot in terms of revenue, now just 0.3% below Penske.

In terms of stock prices, all dealerships saw year-over-year increases in 2020 despite a material decline in the February-April timeline. Lithia's market cap more than doubled while Penske grew the slowest at 7.2% in 2020; the median increase was 29.2% in 2020. In the second half of 2020 after significantly declines at the beginning of the pandemic, the median improvement was 87.1%.

Public Auto Dealers	Ticker	Year-End Market Cap	6 Mo. Change in Market Cap	Y-o-Y Change in Market Cap	2020 Revenue	Y-o-Y Change in Revenue	Dealership Count*	Prior Year Dealer Count	Y-o-Y Change in Dealerships	Y-o-Y Change in Dealerships	Revenue** per Dealership
Penske Automotive Group, Inc	PAG	4,771	53.2%	17.2%	20,444	-11.8%	304	321	-5.3%	-17	$58.9
AutoNation, Inc.	AN	6,132	87.1%	41.3%	20,390	-4.4%	235	236	-0.4%	-1	86.8
CarMax, Inc.	KMX	15,400	5.7%	7.2%	19,883	-4.2%	222	215	3.3%	7	89.6
Lithia Motors, Inc.	LAD	7,763	125.4%	127.2%	13,124	3.6%	209	188	11.2%	21	62.8
Group 1 Automotive, Inc.	GPI	2,313	100.4%	29.2%	10,852	-9.9%	184	186	-1.1%	-2	59.0
Sonic Automotive, Inc.	SAH	1,622	18.4%	21.3%	9,767	-6.6%	100	95	5.3%	5	97.7
Asbury Automotive Group, Inc.	ABG	$2,811	88.4%	29.9%	$7,132	-1.1%	91	88	3.4%	3	78.4

Presented in $000,000s except dealership counts
**Dealership counts per public filings; includes international for GPI and PAG*
***PAG revenue per dealership includes only retail auto dealership revenue*

Public Auto Dealers

As of Year-End 2020

Lithia's recent spending spree is emblematic of a larger trend: the largest auto groups are getting bigger as industry consolidation continues. In the past ten years, the top 150 has increased its market share from 13.0% to 21.1% according to *Auto News*. Since 2010, top 150 store count has increased by 1,560 while only 610 new dealerships have been opened, indicating a net acquisition of at least 950 locations, or 95 stores per year over the past decade.

BIG GROUPS' SHARE GROWS

The 150 biggest dealership groups in the country own an increasing share of total U.S. dealerships over the last 11 years.

	Stores owned by top 150*	Total u.s. dealerships	% in top 150
2020	3,849	18,263	21.1%
2019	3,733	18,317	20.4%
2018	3,699	18,275	20.2%
2017	3,660	18,327	20.0%
2016	3,468	18,261	19.0%
2015	3,466	18,068	19.2%
2014	3,453	18,000	19.2%
2013	2,929	17,875	16.4%
2012	2,626	17,760	14.8%
2011	2,490	17,858	13.9%
2010	2,289	17,653	13.0%

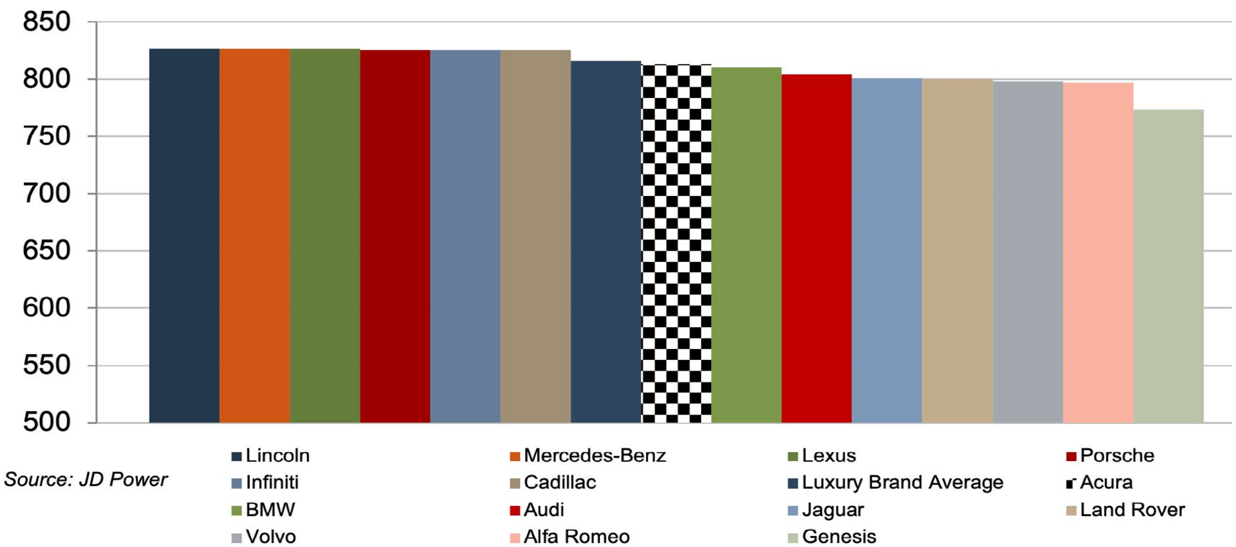
*Some of the groups on the top 150 list have included used-only stores in their dealership counts.
Source: Automotive News Research & Data Center

Public Auto Manufacturers

As of Year-End 2020

Lincoln jumped five spots to the top ranked Luxury brand in terms of SSI to 827, up from 819 in 2019. The largest improvement in ranking came from Genesis, from 728 to 773. Still, Genesis remains the lowest ranked luxury brand in 2020. Land Rover and Acura also improved their SSI scores by over 20 points in 2020. While the order has shifted, the top six brands in 2020 remain Lincoln, Mercedes-Benz, Lexus, Porsche, Infiniti, and Cadillac, all above the luxury average, which increased 11 points. All but two brands (Porsche and Alfa Romeo) saw improvements, and these brands only declined by 2 and 1 point, respectively.

Sales Satisfaction Index (SSI) – Luxury



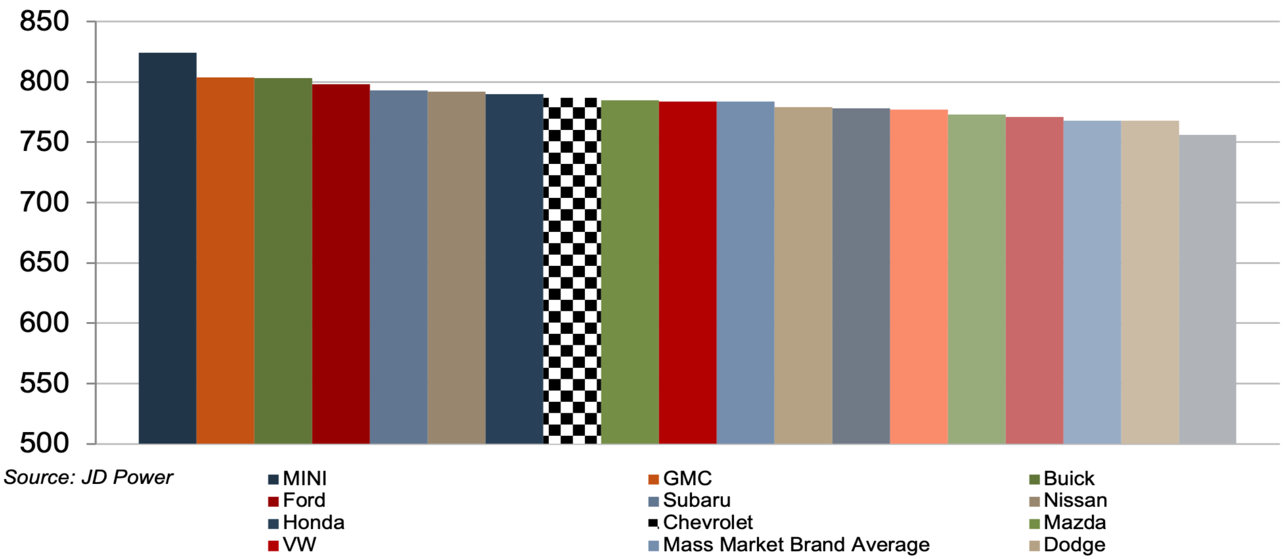
Source: JD Power

Public Auto Manufacturers

As of Year-End 2020

MINI improved its SSI 34 points to reach the top spot for mass market brands in 2020. It is the only brand to perform above the luxury brand average. GMC and Buick each remained in the top three with scores above 800. Other brands to improve their scores by at least 20 points include Dodge (33 point increase), Kia (29), Hyundai (26), Fiat (26), Mitsubishi (23), and Mazda (21). Despite improvements of varying degrees, four brands (Ram, Jeep, Chrysler and Fiat) under the recently rebranded "Stellantis" ranked at the bottom. After significant improvement, Stellantis' Dodge is just below the mass market brand average of 784, which improved 12 points showing general improvement for dealerships regardless of brand. VW was the only mass market brand to see its SSI slip, albeit only from 786 to 784.

Sales Satisfaction Index (SSI) – Mass Market



Source: JD Power

Blue Sky Multiples

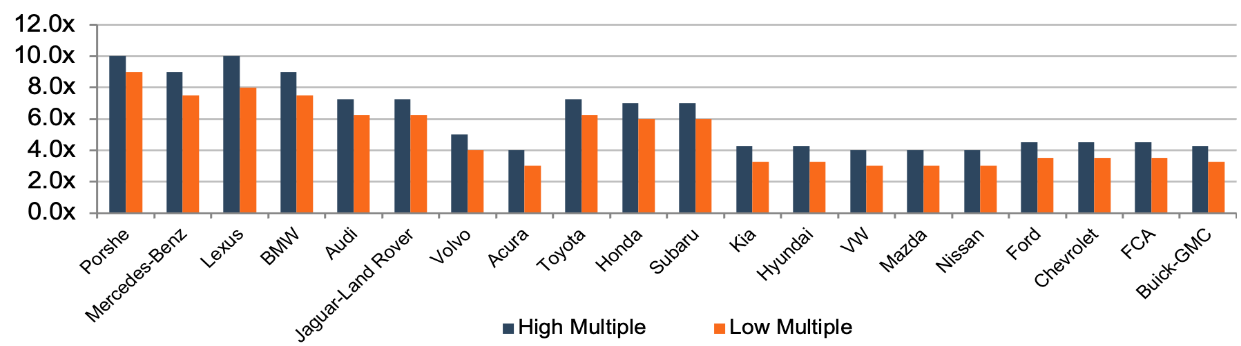
As of Year-End 2020

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 be non-meaningful.

After Q1 declines, valuations partially recovered in Q2 as SAAR rebounded, heightened levels of uncertainty abated, and dealers and the country at large embraced and adapted to the new normal. With reduced uncertainty and higher profits, every brand except Volvo and VW received a higher blue sky multiple in Q3 2020 than Q4 2019 (pre-pandemic). In Q4 2020, the only movement in multiple came from Toyota that crept into the lead for mid-line imports.

While multiples changed on a quarterly basis throughout 2020, notably, so did the earnings stream to which buyers applied the Blue Sky multiples. According to Haig Partners, buyers have historically focused on adjusted profits from the last twelve months, which has been viewed as the best indication of expectations for the next year. Throughout most of 2020, Haig's reported Blue Sky multiples were applied to 2019 earnings as these were viewed as the best indication of a dealership's "run rate" prior to any COVID impact. When profitability improved and uncertainty began to decline around June 2020, multiples applied on these 2019 earnings rebounded. Now into 2021, Haig reports that buyers are using a three-year average of adjusted profits from 2018 through 2020 as the best prediction of future profits. This comports better with the approach taken by Mercer Capital. Given the longer product life cycles, we have historically and continue to take a more long-term approach when assessing the ongoing earning power of an auto dealership.

New and Used Vehicles Sold and Gross Profit per Unit



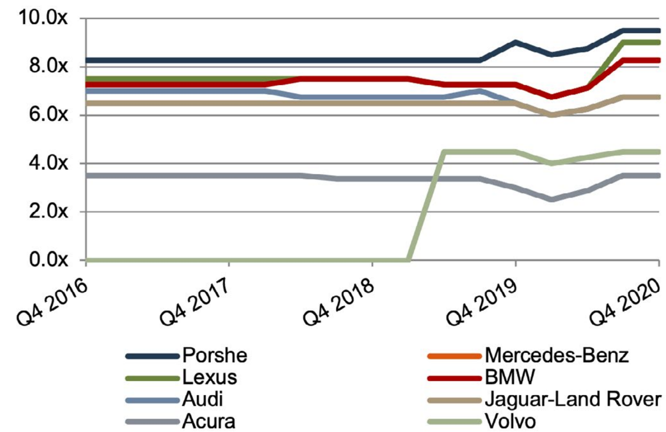
Source: Haig Report

Blue Sky Multiples History

As of Year-End 2020

Luxury Blue Sky History

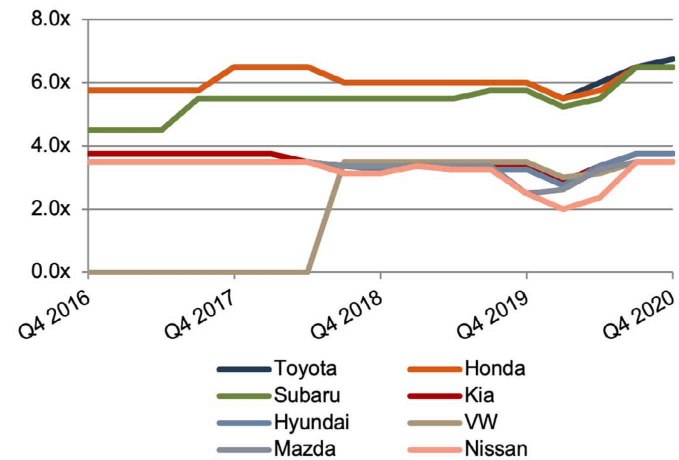
Luxury Blue Sky multiples followed the overall trend described above with drops in Q1, partial rebounds in Q2, then improved multiples in Q3, all relative to Q4 2019 multiples and earnings. Lexus saw the highest increase, from 6.0-7.5x in Q1 2020 to 8-10x in Q4. On the other end of the spectrum, Infiniti, Cadillac, and Lincoln continue to languish as brands without multiples, commanding a Blue Sky value range of up to $1.5 million. Each of these brands suffers from a myriad of issues, including costly facility upgrade requirements, which tend to weigh on Blue Sky values.



Source: Haig Report

Mid-Line Import Blue Sky History

Mid-Line Imports multiples also followed the overall trend, as only VW's Q4 wasn't higher in 2020 than 2019 (each 3.0x – 4.0x). Nissan's Blue Sky multiple in Q1 2020 declined to a paltry 1.5x on the low end, the lowest ever reported by Haig for any brand dating back to 2013. This was driven by troubles that began before the pandemic as corporate turmoil and an aging lineup weighed on dealer profits. At Q4 2020, this had rebounded to 3.0x – 4.0x, the highest for the brand since Q2 2018. Nissan dealers that held on during the last few years have been rewarded. As noted previously, at the top end of mid-line imports, Toyota snuck its nose ahead of Honda, to pace the segment at 6.25x – 7.25x, on par with Jaguar/ Land-Rover and Audi. Q2 and Q4 2020 were the only two quarters on record in which Toyota dealers have outpaced Honda, albeit only at a quarter turn multiple difference. Meanwhile, Subaru has caught up to Honda at 6.0x – 7.0x, a gap that has steadily narrowed since Subaru was closer to a 4.0x-5.0x multiple in 2016.



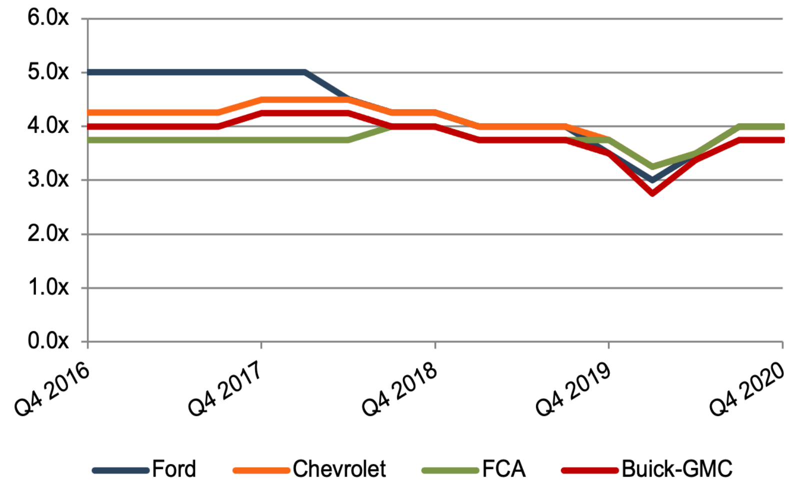
Source: Haig Report

Blue Sky Multiples History

As of Year-End 2020

Domestic Blue Sky History

Domestic franchises continue to move largely in lockstep with each other as Buick-GMC remains just below the others who command a 3.5x to 4.5x multiple. Domestics continue to outpace many of the mid-line imports, reminding everyone that vehicle pricing power is not the sole consideration in these multiples. Luxury vehicles frequently receive the highest multiples. However, three luxury brands continue to not even receive a multiple while Volvo and Acura are on par or below their domestic counterparts.



Source: Haig Report

MERCER CAPITAL

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
- Litigation support for economic damages and valuation and shareholder disputes

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