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VALUE FOCUS

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 Auto Dealer Industry Metrics Review

As we turn the calendar to April, 2022 is in the rearview mirror and year-end statistics for the auto industry have been released. How did the industry perform, and what do the metrics tell us about the direction of the industry in 2023? In this article, we discuss the key metrics we track for the industry: new vehicle profitability, the supply of new vehicles, average trade-in equity values of used vehicles, the used-to-new vehicle retail unit sales ratio, fleet sales, and vehicle miles traveled.

New Vehicle Profitability

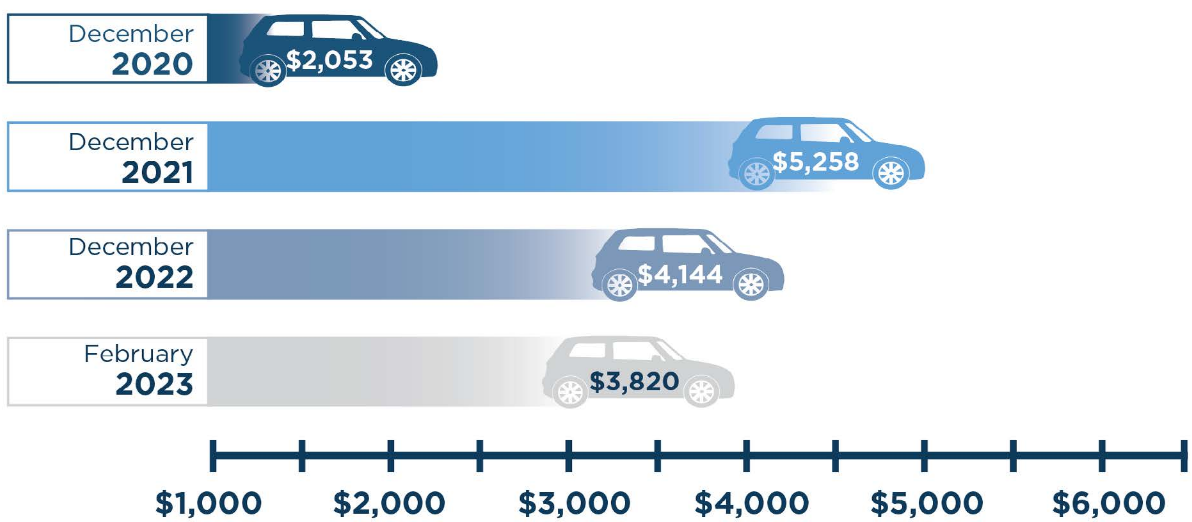
Total retailer profit per unit realized by auto dealers continues to remain strong despite a trio of trends: demand may be cooling, incentives offered by manufacturers have increased slightly, and vehicle supply continues to improve. But has this metric peaked? The graph on the next page illustrates the current and historical estimates (provided by the **JD Power** and **LMC Automotive** forecasts) that have declined since the year-end high-water mark of $5,258 at December 2021. While these figures have cooled in recent months, the February 2023 figure of $3,820 per new vehicle unit is still almost double the margin that dealers were experiencing in December 2020 and more than three times the margin realized in December 2019.

2022 Auto Dealer Industry Metrics Review

(cont.)

For context, JD Power reports that 37% of new vehicles sold above MSRP in December 2022, compared to 50% of new vehicles selling above MSRP in July 2022. If these trends continue along with increased incentives from manufacturers, average transaction prices for new vehicles could cool slightly in 2023, despite inflation and increased input costs for the OEMs.

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



Source: JD Power - LMC Automotive Monthly Forecasts

2022 Auto Dealer Industry Metrics Review

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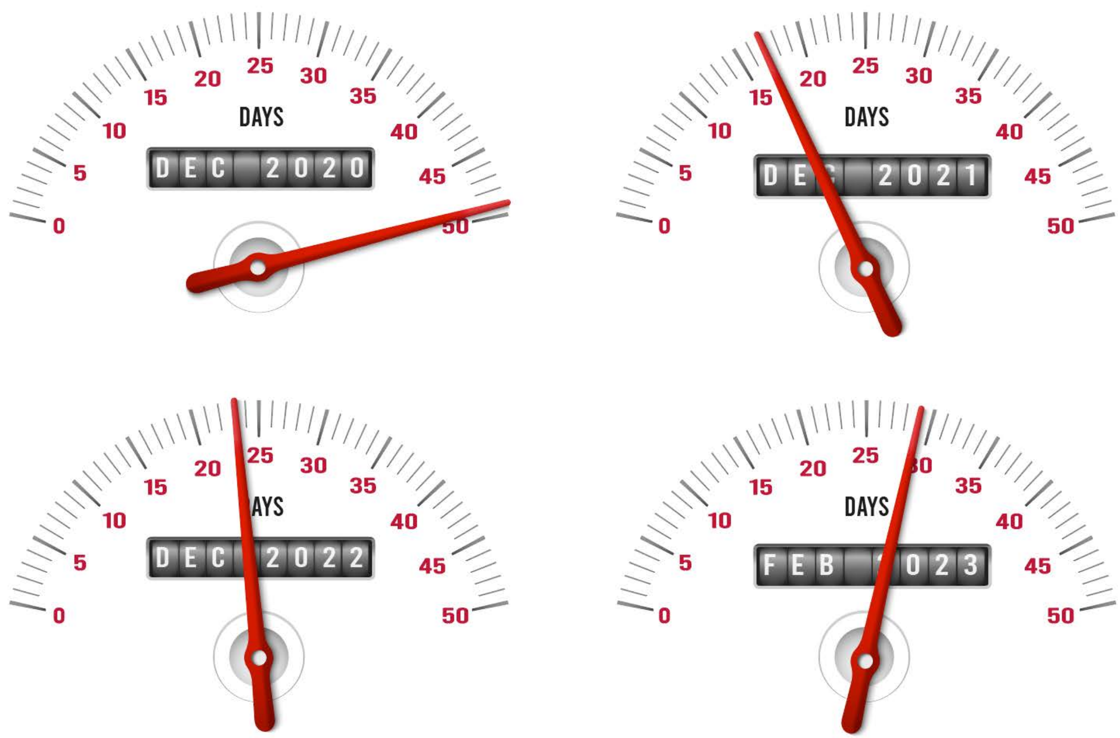
Supply of New Vehicles

For the last couple of years, evidence of a tight supply of new vehicles could be seen in the lack of inventory on auto dealer lots across the country. We've written about average days' supply for both new and used vehicles on **our blog** on numerous occasions. We've also viewed this trend from a similar metric that measures the average days a new vehicle sits on a dealer's lot before it is purchased. The monthly forecasts provided by JD Power/LMC Automotive, report these figures as 23 days and 29 days as of December 2022 and February 2023, respectively. Both figures indicate a steady climb and slight improvement over the prior-year-end low of 17 days at December 2021. While most experts are cautiously optimistic that the auto OEMs will not revert back to the historical levels of production and inventory, the illustration below shows the context of the latest two figures to historical year-end figures.

Average Time New Vehicle on Dealer's Lot



Source: JD Power - LMC Automotive Monthly Forecasts

2022 Auto Dealer Industry Metrics Review

(cont.)

Embedded within these average day figures, dealers continue to pre-sell a large portion of their reduced vehicle allocations during this post-pandemic transition and recovery from the microchip shortage. JD Power indicates that 47% of new vehicles are actually selling within ten days of arriving on a dealer's lot. For context, this percentage is down from 57% of new vehicles sold within the first ten days on the lot in March 2022.

Average Trade-In Equity Used Vehicles

Like new vehicles, used vehicle transaction prices also soared during 2022 but have cooled some recently. Since fewer new vehicle units have been available to sell over the last few years, fewer used vehicles are traded into the dealer for resell. Increased demand for used vehicles led the average trade-in equity value for used cars to climb during the same period. Like the other trends previously discussed, the average trade-in equity value for used vehicles also appears to be softening at the end of 2022 and early 2023. According to the monthly forecasts from JD Power/LMC Automotive, the average trade-in equity value totaled $9,316 and $8,895 for December 2022 and February 2023, respectively.

With rising interest rates, consumers tend to focus more on monthly payments. Despite average used vehicle transaction prices cooling slightly, we anticipate many consumers will choose to hold on to their vehicles longer during this time. As such, if the average trade-in equity value of used vehicles continues to decline, we expect it to impact transaction prices similarly. With vehicles depreciating more quickly from the elevated purchase prices experienced in the last couple of years, more consumers may be "upside down" on their used vehicles if the trade-in value declines below their remaining loan balance. We expect this will be a hindrance to purchasing a new vehicle or a newer used vehicle. The question becomes how much this will affect demand. If vehicle prices and interest rates remain elevated, it will be difficult to roll negative equity into a higher loan balance when consumers trade in without materially increasing monthly payments.

2022 Auto Dealer Industry Metrics Review

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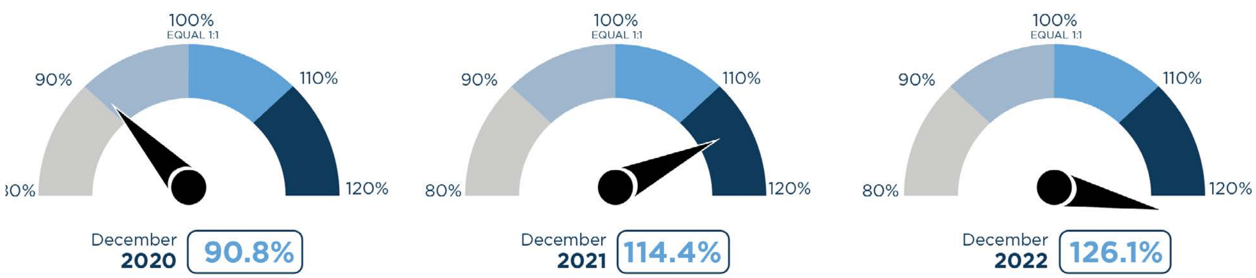
Used-To-New Vehicle Unit Ratio (Retail Only)

The figure below depicts the ratio of used and new vehicle units retailed.

Used-to-New Vehicle Unit Ratio (Retail Only)



Source: NADA Dealership Profiles, Cox Automotive and JD Power/LMP

Historically, the gap between profits per unit earned on used and new vehicles was wider. For several years, auto dealers have been making nearly as high margins on new vehicles as used vehicles. Despite improvements in production and supply, this ratio continues to be impacted by those conditions and the slow recovery from the microchip shortage. While average transaction prices for new and used vehicles continued to climb during the second half of 2022, most experts predict that average transaction prices for new and used vehicles will cool slightly in 2023. With those conditions and the moderate improvement in new vehicle supply that is expected to continue in 2023, we expect the ratio of used to new vehicles to decline in the coming years.

Fleet sales

Fleet sales consist of sales to large rental car companies, commercial users, and government agencies. Historically, fleet sales allowed auto dealers to sell surplus inventory and to sell larger blocks of units at a time. While fleet sales typically occurred at reduced margins compared to retail sales, they allowed auto dealers to put more vehicles in service to hopefully benefit the fixed operations of an auto dealer as those vehicles will eventually require service maintenance and parts. It also frees up capital for dealers to redeploy into inventory that will either sell at higher margins or turnover more quickly. Auto dealers anticipate that buyers of new vehicles will continue to return to the same dealership for those services during the lifetime of the warranty period and hopefully beyond.

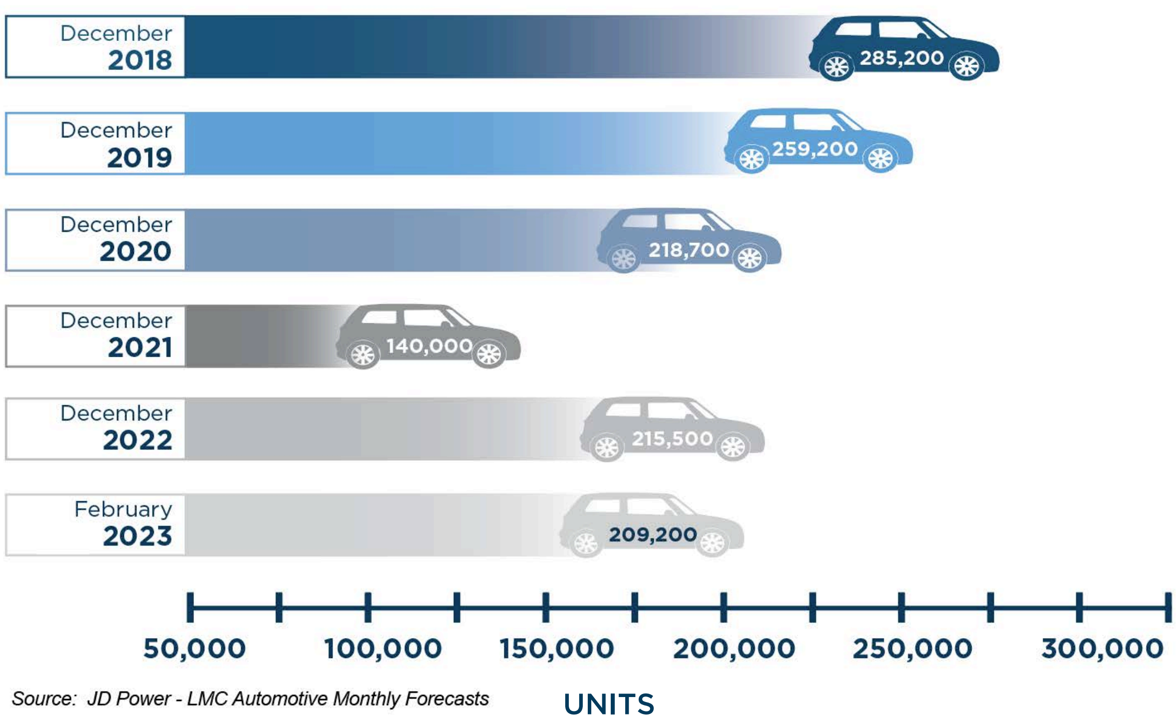
2022 Auto Dealer Industry Metrics Review

(cont.)

During the height of the pandemic, fleet sales declined significantly. Rental car companies weren't just canceling orders; they actively sold off their existing fleet to build up cash as cities endured temporary shutdowns and much of domestic travel was halted or significantly curbed. With travel returning and inventory supply improving, fleet sales are steadily increasing. As seen in the graphic below, monthly fleet sales (in units) for December 2022 were estimated to be 209,200, the highest year-end total since December 2020.

Continuing the trend into 2023, January and February have posted strong fleet sales (in units) estimates at 183,300 and 209,200, respectively. While January and February's figures are stronger than the last several years, they still fall short of early-year levels in 2019 and 2020. It should be noted that, historically, monthly fleet sales are strongest at year-end and the early part of the following year as dealers look to move the prior year's inventory.

Monthly Fleet Sales (in units)



Source: JD Power - LMC Automotive Monthly Forecasts

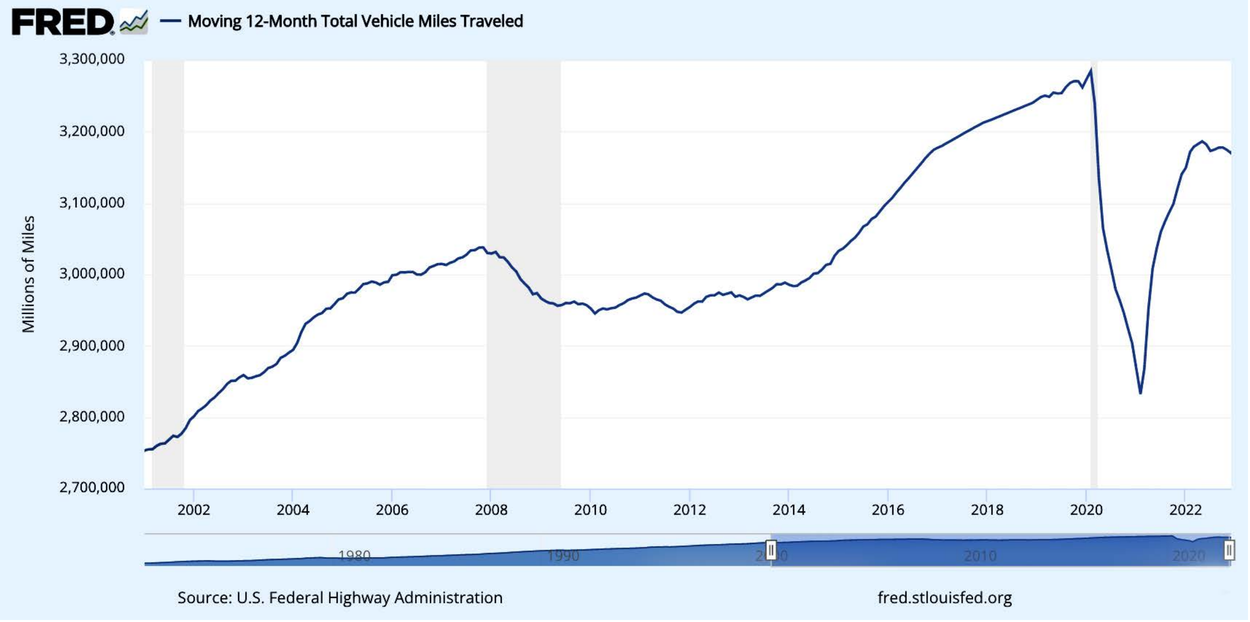
2022 Auto Dealer Industry Metrics Review

(cont.)

Vehicle Miles Traveled

Another key indicator that portrays the health of the automotive industry is the number of miles driven or vehicle miles traveled ("VMT"). As with the number of vehicles in service, the number of miles driven contributes to the fixed operations of an auto dealer as vehicles will require more parts and service as they are driven more frequently or for longer distances. Increased miles will also lead to the eventual purchase of a new vehicle from the new or used vehicle inventory. VMT has been tracked since 1971, and a graphical view of the rolling 12-month average from 2000 through current can be seen below:

Over time, VMT has generally increased as the population has grown and more vehicles have been put in service. Since 1971, there have only been a few occasions where the rolling-12 month average has declined, which, as you'll note, tend to correlate with recessions: 1974, brief periods in the late 1970s and the early 1980s, the Great Recession in 2008 and 2009, and the pandemic in 2020. During the height of the pandemic, the rolling-12 month VMT average dropped below 3 trillion miles for the first time since mid-2014 and even below 2.8 trillion for the first time since the early 2000s.



2022 Auto Dealer Industry Metrics Review

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The rolling 12-month average bottomed out in February 2021 at approximately 2.77 trillion miles but steadily climbed back to 3.23 trillion miles in March 2022, indicating almost a full recovery to the high water mark of 3.28 trillion miles in February 2020.

So how did the rolling 12-month average fare in the second half of 2022? Vehicle miles traveled have plateaued and declined to approximately 3.17 trillion miles as of December 2022. Perhaps this indicates some of the impacts following the great resignation and increased numbers of workers that either work remotely full-time or on a part-time basis. Those workers have much fewer miles to commute than before the pandemic.

An auto dealership's service and parts department usually performs somewhat counter-cyclically to other departments during economic downturns and recessions. When consumers face pricing pressures, higher interest rates, and economic uncertainty, they often choose to hold on to their vehicles for a longer time, forcing the need for increased service work. Auto dealers would be wise to focus on the service and parts department if profits are normalizing on the sale of new and used vehicles. The service and parts department has historically performed as one of the highest profit centers in the overall dealership.

Conclusions

2022 marked another very successful year for auto dealers. Most of the metrics discussed in this post seem to have peaked at some point during 2022 and are shifting in the other direction. Does this signal that profitability has peaked? Will increasing volumes compensate for declining unit economics? Only time will tell. Despite cooling metrics, dealers can be optimistic that profitability and other trends continue to experience heightened levels over pre-pandemic figures, sometimes still in the magnitude of two or three times higher.

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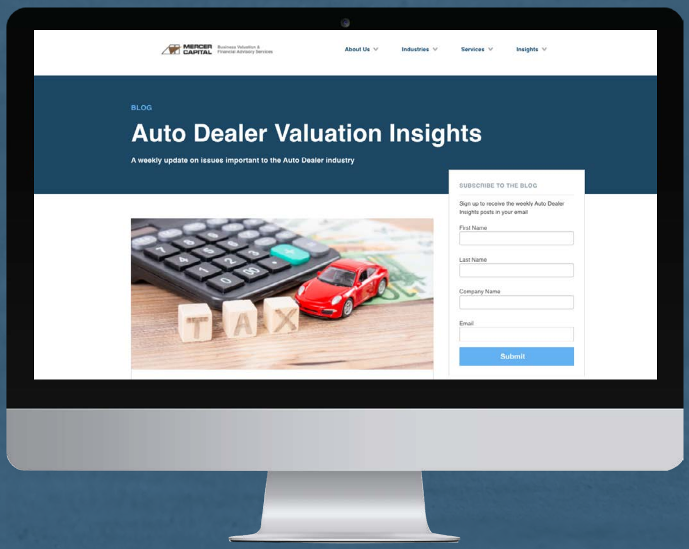

Q4 2022 Earnings Calls

Executives Anticipate a Return to Normal

In 2022, fewer than 14 million light vehicles were sold, the lowest level since 2011. Supply constraints hampered production from automakers, which led to higher profits for auto dealers on each vehicle they were able to acquire and sell, both new and used. Vehicle production improved gradually throughout the year, which is anticipated to continue through 2023.

After reviewing earnings calls from executives of the six publicly traded auto dealers, the consensus is that volumes will increase approximately 10% to about 15 million in 2023, but gross profit per unit ("GPU") will decline as supply constraints are alleviated. Nobody is anticipating that record-setting unit-level profitability will continue, though most expect, or are at least hopeful, that "normalized" levels will be higher than pre-pandemic.

With supply returning, analysts questioned whether sales volumes would be constrained by demand rather than supply. Most executives demurred, giving various reasons why demand concerns were not impacting their company. Asbury noted it was still pre-selling 35% of its inventory, suggesting that the supply/demand imbalance won't be restored until this level approaches more historical levels of effectively 0%.

Q4 2022 Earnings Calls

Executives Anticipate a Return to Normal

(cont.)

Improved new vehicle availability has negatively impacted used vehicle prices as consumers are no longer forced to substitute new for used. With the ratio of average selling prices of used to new vehicles returning to historical levels, dealers with larger levels of used inventory with heightened acquisition costs are seeing their profitability suffer.

While this impacted the public dealers to varying degrees, some expressed optimism that used vehicles would get a boost in future periods as the constrained production years cycle through the vehicle life cycle. In other words, a low supply of new vehicles now means that there will be a low supply of used vehicles down the road.

Fixed operations have been a bright spot for dealers showing growth across the board. This is partly due to consumers returning to driving more; more driving means more collision work. Fewer new vehicles on the road also indicate the average age of vehicles has increased, which raises the demand for parts and service.

As a follow-up to our **Q2 earnings call blog,** we pondered how auto dealers would reinvest their profits from this past cycle and commented on an alternative growth opportunity for auto dealers in the **powersports industry**. It seems Sonic Automotive was listening as they announced their foray into the space last month. Management highlighted the following benefits of investing in the industry:

- Expand into an adjacent retail sector with similar operating models
- Significant opportunity for consolidation due to fragmentation
- Higher margins than auto dealers
- Lower acquisition multiples

Here are some other major themes from the Q4 2022 Public Auto Earnings Calls:

Theme 1: SAAR Expectations

Auto retail executives weighed in with their SAAR expectations as 2022 volumes were the lowest in a decade. While everyone is calling for an increase, expectations are for a more moderate recovery rather than a bounce back to 2014-2019 levels.

Q4 2022 Earnings Calls

Executives Anticipate a Return to Normal

(cont.)

"We are planning our business for a SAAR in the mid 14 million range. We believe with our disciplined cost management and agile expense structure heading into 2023, we can adapt to changing conditions, including one with a recovering if uneven day supply for the industry. […] the last few years have been difficult to navigate it from a prediction standpoint between COVID and supply chain issues and so on. But I'll tell you, all the conversations the last few quarters have been when does it get back to '19 levels, I just don't see that. '19 have a 17 million SAAR, we're forecasting less than a 15 million SAAR."

– David Hult, CEO, Asbury Automotive Group

"After experiencing the lowest new vehicle SAAR since 2012, we anticipate SAAR in 2023 to be between 14.5 million and 15 million units. As perspective, the industry averaged 17 million vehicles SAAR between 2015 to 2019, implying a future lift of 17% in addition to conquesting market share."

– Bryan DeBoer, President and CEO, Lithia Motors

"[SAAR is] Probably a 10% increase over this year, somewhere between 14.5 and 15.1, 15.2, 15.3 is what we're projecting in our numbers. Margins is the big — is going to be the big question. Certainly, they're not going to stay where we saw them north of $6,300 in the fourth quarter. In the first quarter, we're seeing that number in the high-5s."

– Jeff Dyke, President, Sonic Automotive

Theme 2: Long-Term Days' Supply and GPUs

Due to constrained supply in the last three years, gross profit per unit increased as demand outstripped supply. As production improves, volumes are expected to increase and gross product per unit is anticipated to decrease. The question for dealers is whether volume improvements will compensate for unit profitability declines, but the general consensus is that GPUs will remain above pre-COVID levels. Roger Penske appeared to suggest GPUs might decline by $2,000 in 2023. Executives also emphasized the importance of considering days' supply rather than absolute levels of inventories.

Q4 2022 Earnings Calls

Executives Anticipate a Return to Normal

(cont.)

"You can look back over history; when SAAR's are below 16 million, margins hold up pretty well. We think a lot of the OEMs have learned from their days supply, but that doesn't mean you won't have spikes at certain moments in time. I think they've been real comfortable with not bringing large incentives to the market. If inventory goes back up on a day supply, I assume they'll come forward with incentives. And again, because the average age of the car is over 12 years, while we think it's not going to be a gangbuster year, we anticipate margins to hold pretty well. It will certainly vary by OEM depending upon the day supply. But as we look at Asbury as a whole, we think it'll be a pretty good year for new car margins for us. […] In the fourth quarter, one of our domestic brands, the day supply, I would say, got back to close to normal levels. And the gross margins with that brand were significantly higher than what they were in 2019. So we have confidence that our margins will be significantly higher in '23 than they were in '19. But certainly, you can tell it's fallen off from prior year results."

– David Hult, CEO, Asbury Automotive Group

"I think the key for us is not absolute numbers of inventory, but how that translates into day's supply as we go through the year. And that obviously brings you on to one of the key questions and that's what we think is going to happen with new vehicle volume. I think there's strong potential for new vehicle volume under the right circumstances to be above 15 million, and I think we'll end the year with continued low – very relatively low, frankly, when you look back at some of the previous year's inventory levels on a days' supply basis. I think there will be some continued mitigation on new vehicle margin. But frankly, if you look at what happened over the period of 2022, really, I just see a continuation of that, but somewhat compensated by volume increases. […] I think the reality is that new GPUs [were] never going to be sustained at [that] level. And we've been talking about it for a long period of time that as new inventory levels begin to restore in the franchise network that you're going to see a better balance. And I say better because it brings some volume back here in GPU's drop, but ultimately what you're trying to do is maintain the overall level of profitability."

– Michael Manley, CEO, AutoNation

"We expect a gradual decline in new vehicle margins over the course of 2023 as inventory continues to recover. We do, however, expect normalized new vehicle margins to eventually settle above our pre-pandemic levels. I can't tell you with any specificity when we think it will normalize, other than what we've seen is a real steady glide path really since middle of last year, the gross profits decline, and we expect we'll see something similar through this year. And in some brands, our grosses are holding up quite well because they're still very tight. […] In a couple of brands, we saw the gross has increased during the quarter. And then, we got quite a bit of inventory in a couple of brands. In our domestics, we saw the most erosion."

– Daryl Kenningham, President, U.S. and Brazilian Operations, Group 1 Automotive

Q4 2022 Earnings Calls

Executives Anticipate a Return to Normal

(cont.)

"We believe earnings will be impacted by declining GPUs and are assuming the following: same-store unit growth for new in the mid-to-low single digits and used in the high-single digits, as we navigate this transitory environment with supply and demand normalizing, new vehicle GPUs will continue to moderate, assuming a decline of about $200 per unit each month throughout 2023, this would average to a GPU of $3,800 and end the year a little above pre-pandemic levels."

– Tina Miller, SVP and CFO, Lithia Motors

"Incentives are going to come back as inventory comes back. And as that starts rising and they've got to turn out of inventory, that's going to happen, and margins are going to fall. We're working with our manufacturer partners to make sure they understand keeping that they supply at a reasonable level, call that 25 to 35 days instead of pre-pandemic 60 to 80 days is the right way to run this business. And I think they all agree with that. […] The manufacturers recognize that, and they'll do a good job of trying to keep incentives down which will keep pricing somewhere in the MSRP range as we move forward."

– Jeff Dyke, President, Sonic Automotive

Theme 3: Used Vehicle Prices, Affordability, and Availability in the Coming Years

When new vehicle production declined, consumers were forced to turn to used vehicles, causing used vehicle prices to appreciate faster than new vehicles. The unwinding of this unsustainable price difference between new and used vehicles is the primary reason for the decline in used vehicle prices. While used vehicle prices have been volatile over the past few quarters, public auto retailers are generally seeing a stabilization in the market. A couple of executives went the extra step to indicate that constrained new vehicle supply over the past few years will lead to lower availability of used vehicles in the coming years, which should support used vehicle prices in the future.

"Used retail revenue was down 5% from the per year quarter as the expected choppiness to the market persisted. Used retail gross profit per vehicle was $1,842 for the quarter, a decrease of $840 from the per year quarter. Our used vehicle inventory [had] a 26 day supply. Our used to new ratio for the quarter was 101%, down from 108% from the prior year quarter. […] We are seeing the use car valuation and pricing stabilizing. We also go to keep in mind we are approaching our selling season for a lack of a better term, and also what comes with the tax credit. So, we feel that the big valuations that we saw Q3 into Q4 will definitely stabilize.

–Daniel Clara, SVP of Operations, Asbury Automotive Group

Q4 2022 Earnings Calls

Executives Anticipate a Return to Normal

(cont.)

"We are entering a period of tight supply on two and three and four-year old vehicles, which make up the majority of these car sales. And that's going to impact wholesale prices and ultimately retail prices, margins I think are going to be fine."

– Joe Lower, CFO, AutoNation

"One of the continued challenges we faced in the quarter was a decline in industry used vehicle pricing, which results in a used vehicle sequential margin decline of $235 to roughly $1,350. Partially offsetting this was an 8% increase in same store used vehicle unit sales. […] Well, the trade off on volume in GPUs, we want to err on the side of volume. Not that it's volume at all costs. That's never something we want to do. […] We want to be at the market or better all the time. And then we want the volume because of the F&I attachment, which is a real strength for us. Also, that puts more units in operation out there for our stores and another opportunity for us to do parts and service business with those customers. So, philosophically, we like that volume versus GPU trade-off for that reason. Moving forward, if you look at it on a macro basis over the next couple of years, what firms like Cox are saying, which I tend to agree with them, is I believe we're going to see somewhat of a shortage on used cars because of the pandemic-related SAAR declines that we saw for three years. And that will take some used cars out of the market for the coming three or four – couple of years anyway. And I believe that could support [GPU]s over the next couple of years."

– Daryl Kenningham, President, U.S. and Brazilian Operations, Group 1 Automotive

"We remain aggressive on retaining trades we are offered, as well as the continued procurement of inventory from all external channels even as pricing pressure on use continues with the rising interest rate environment and recovering new vehicle inventory supply. Transitory issues and pricing pressure on used vehicles should have a minimal impact on 2023, as we carry less than a 60-day supply and the shortage of late-model used vehicles from the abnormally depressed new vehicle SAAR environment takes years to normalize."

– Chris Holzshu, EVP & COO and CEO, Lithia Motors

"New car inventory is coming back, the supplies are increasing. Domestic supplies are increasing. We're going to see that across the board. And as that happens, you just can't help but have a drop in used vehicle valuations. […] But that's also why you run a really tight day supply. If you're caught up with a 40, 50, 60 day supply right now, you've got problems coming your way. And we just don't have that."

– Jeff Dyke, President, Sonic Automotive

Q4 2022 Earnings Calls

Executives Anticipate a Return to Normal

(cont.)

"Used vehicle average selling prices have begun to decline, but still remain well above levels required to return to a monthly payment that is affordable for the average buyer at current interest rates. Used vehicle gross profit was down 29%, driven by a 33% decrease in used retail GPU to $1,405 per unit, offset partially by a 6% increase in retail unit volume. Given ongoing new vehicle inventory constraints, recent declines in wholesale market pricing and our current outlook, we continue to be disciplined in managing our used vehicle inventory, volume and pricing in order to optimize gross profit levels as we go through 2023."

– David Smith, CEO, Sonic Automotive

Theme 4: Fixed Operations Growing as Vehicles Age

Companies reported broad-based growth in all segments of fixed operations, which is anticipated to continue into 2023—in part due to aging vehicles.

"I assume, most like us, we never have enough techs, and we can always use more. I think what you're seeing with the dollars increasing has more to do with the aging of the car. As the cars age, they need more work and certainly parts costs go up every year. So, as we look at '23 from a growth standpoint, at least at this point, we don't think it's going to look very similar to what our results were in '22 as far as growth. We don't see it slowing down or leveling off. People are holding onto their cars longer. And if the jobless rate increases over time that will certainly have an impact on parts and service, but we believe that'll be a positive impact."

–David Hult, CEO, Asbury Automotive Group

"Our customer pay business generated 13% same-store growth. Collision increased 14%, warranty 8% and wholesale parts 3%. Through our technician recruiting and retention efforts, we increased our same-store technician headcount by 16% in 2022. We foresee after sales continuing to be a strength over the course of 2023 for Group 1."

–Daryl Kenningham, President, U.S. and Brazilian Operations, Group 1 Automotive

"Our aftersales business remains strong across all business lines, up 8.4% in the quarter. With the record units in operation and an average age of vehicle over 13 years, we anticipate continued growth throughout 2023."

– Chris Holzshu, EVP & COO and CEO, Lithia Motors

Q4 2022 Earnings Calls

Executives Anticipate a Return to Normal

(cont.)

Conclusion

At Mercer Capital, we follow the auto industry closely in order to stay current with trends in the marketplace. These give insights 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.

David Harkins

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

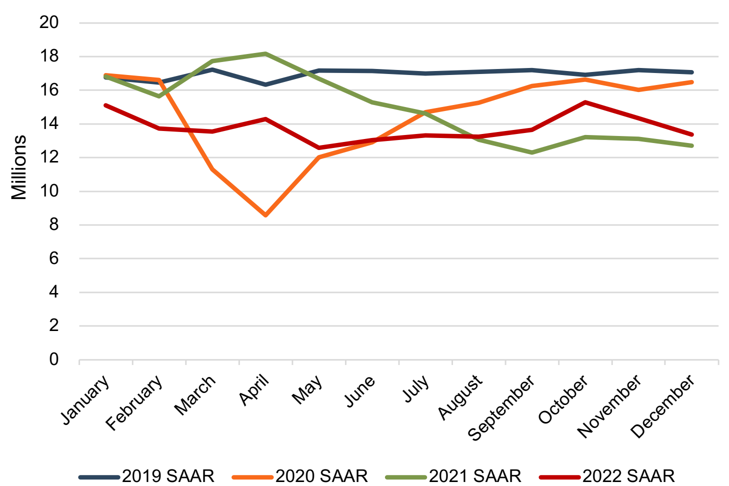
As of Year-End 2022

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 13.3 million units in December 2022, up from 12.7 million units last December. Supply chain disruptions that began in the summer of 2021 persisted throughout the year, and total light vehicle sales in the U.S. were the lowest since 2011. In the latter half of 2022, auto production reports showed signs of a recovery but did not translate to a full recovery in the SAAR. Take a look at the graph on the left for perspective on the 2022 SAAR when compared to the last three years.

SAAR, by definition, adjusts for seasonality such as typically higher sales in December and March compared to lower sales in January and February. However, the graph on the right shows a material decline in April 2020 due to the onset of the COVID-19 pandemic. This dive in the SAAR and the volatility that has followed may obscure analysis going forward.

SAAR as of Year-End 2022



Source: Federal Reserve Economic Data

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

Source: St. Louis Fed

Blue Sky Multiples

As of Year-End 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, five brands seeing improvements, and two brand ranges increasing more than once in that time. Elevated earnings have led to higher values for dealerships across the board even without significant increases in multiples. However, Haig is calling record profits in 2022 a peak given trends in the back half of the year. They believe Blue Sky values declined about 13% in the second half of 2022 from their peak at Q2 2022.

Generally, multiples are at or near their highest points in recent years. Going back to Q4 2018, only domestic brands have lower multiples as of Q4 2022. All mid-line import brands are at their highest level since Haig began publishing multiples in 2014. Seven of the ten luxury franchises covered by Haig are also at peak multiples.

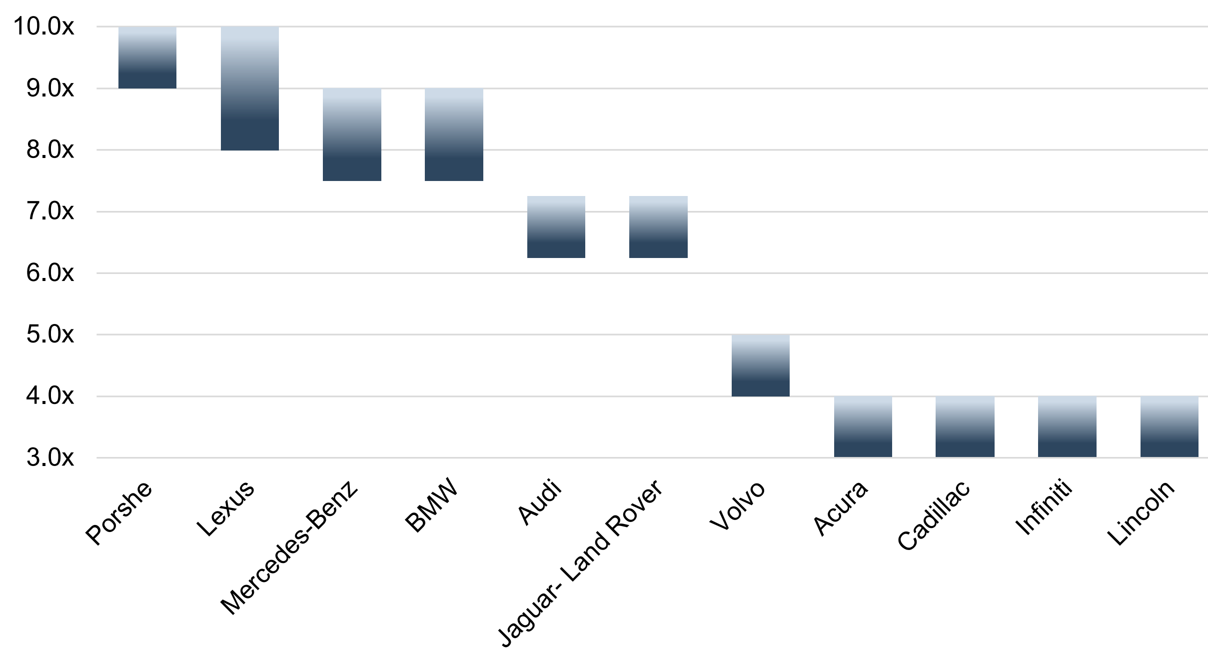
Blue Sky Multiples History

As of Year-End 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 nine quarters. Porsche remains the most valuable franchise covered by Haig Partners with a range of 9-10x, just above Lexus with the widest range from Haig at 8-10x. Haig indicated that only Ferrari dealerships fetch a higher multiple, though it did not indicate a range for Ferrari, likely due to scarcity. Only three luxury brands are not currently at their peak multiple, and coincidence or not, they're all German: Mercedes-Benz, BMW, and Audi. Haig continued to caution that MB management's use of its Rights of First Refusal in buy-sells may eventually have a negative impact on valuations as it tends to prefer buyers who already own their brand. While there is still ample demand from existing Mercedes dealers, limiting the potential buyer pool may eventually bring down its Blue Sky multiple range.

Luxury Blue Sky Multiples Range



Source: Haig Partners

Blue Sky Multiples History

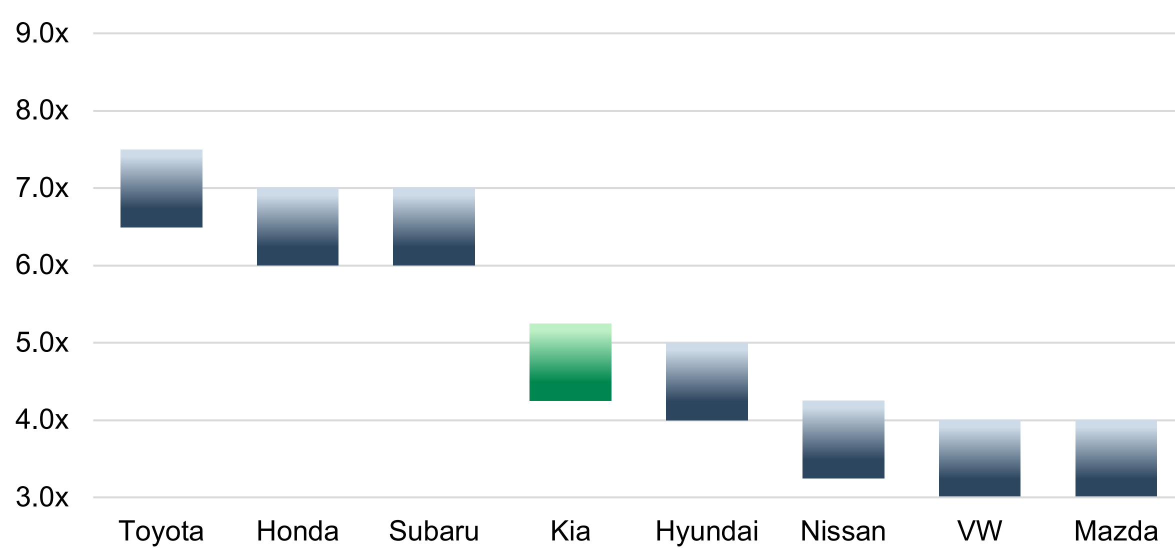
As of Year-End 2022

Mid-Line Blue Sky Multiples History

Beginning in Q3 2021, Hyundai and Kia began pulling away from the lower end of the mid-line import brands, increasing by 0.5x in Q3 2021 and 0.25x in Q1 2022. In Q4 2022, Kia was the only brand to see an improved multiple due to high demand from buyers, leaving it just ahead of Hyundai. Haig's Blue Sky multiple range for the two brands has either been equal or within 0.25x of each other for the past ten years, but Kia has never had a lower range than Hyundai.

Haig reports that Honda has struggled the most with supply chain issues, which has caused it to lose ground to Toyota, Hyundai, and Kia. To make matters worse, Haig is also now cautioning that Honda is also exercising its Right of First Refusal, which may restrict ownership opportunities of the brand and could lead its multiple range to be more in line with Hyundai and Kia than the cream of the crop mid-line brand in Toyota.

Mid-line Blue Sky Multiples Range



** Green indicates an increase in the multiple from the previous quarter*

Source: Haig Partners

Blue Sky Multiples History

As of Year-End 2022

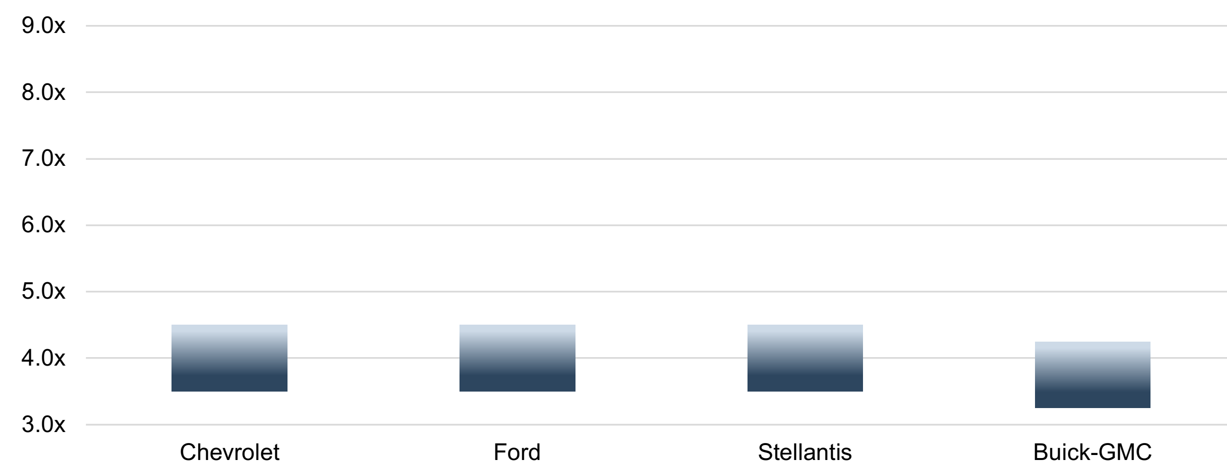
Domestic Blue Sky Multiples History

Domestic franchise multiples have not changed since Q3 2020. With the rise of Hyundai and Kia's multiples over the past year and a half, 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.

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 Q4 2018, these brands' multiples were 0.25x higher than they are in Q4 2022. Stellantis actually increased over that same period but only by 0.25x.

Haig noted various issues for each of the domestic brands, which limits their valuations. Ford has been the most vocal about significant investments by dealers in order to sell electric vehicles. The significant upfront investment without certainty of future demand limits what a buyer will pay for the franchise's dealerships. While Chevy appears to have handled supply chain issues better than most, dealers note the products it is making do not always align with consumer demand. Stellantis is positioning itself with the priciest average domestic vehicles, and buyers of this franchise are encouraged about the dealerships who are able to make high profits, though this is not a uniform outcome. Buick-GMC has low volumes and requires EV investment, which has led many dealers to sell their franchise back to the OEM.

Domestic Blue Sky Multiples Range



Source: Haig Partners

Guidline Public Company Analysis

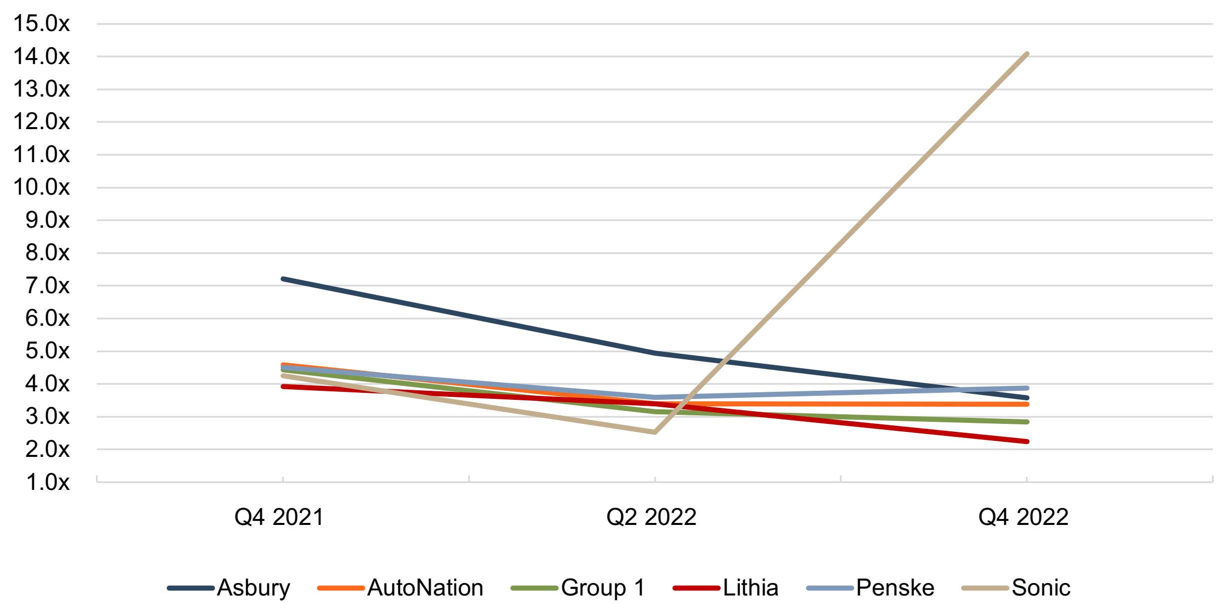
As of Year-End 2022

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.

The average LTM Blue Sky multiple for the public auto dealers (5.00x) is notably higher than it was mid-year 2022 (3.50x), hinting at a possible recovery in market valuations. However, this increase in the average can mostly be attributed to Sonic Automotive's outlier multiple of 14.1x, which can be traced back to a large goodwill impairment charge and thus lower reported earnings. In fact, four of the six companies' LTM multiples actually fell since mid-year as earnings growth remained strong. Despite general declines, the median LTM Blue Sky multiple still edged up from 3.40x to 3.48x because Sonic went from the lowest multiple as of mid-year to the highest multiple at year-end. The chart below provides a visualization of the movement of public auto dealer multiples and it is easy to see how Sonic's multiple impacts the average of the group.

LTM Blue Sky Multiples



Source: Haig Partners

Guideline Public Company Analysis

As of Year-End 2022

Blue Sky Multiples (cont.)

Using a 3-year average methodology instead, Blue Sky multiples decline to an average of 5.63x, compared to 6.76x at mid-year even with the outlier year in Sonic's earnings. The difference between LTM and three-year average multiples demonstrates the considerably heightened level of earnings that occurred in 2022, which were 43.5% above three-year averages. As discussed elsewhere in the newsletter, earnings are anticipated to decline going forward, which leads FWD Blue Sky multiples to be higher than LTM multiples. Still, FWD earnings are above three-year averages, supporting the notion that it will be a gradual decline towards more normalized levels.

Implied Blue Sky Multiples	Asbury	AutoNation	Group 1	Lithia	Penske	Sonic	Average	Median
Stock Price	$179.25	$107.30	$180.37	$204.74	$114.93	$49.27		
less: Tang. Book Value per Share	$31.53	$2.29	($4.28)	($69.21)	($18.69)	($7.38)		
Implied Blue Sky per Share	$210.78	$109.59	$176.09	$135.53	$96.24	$41.89		
LTM Earnings per Share	$44.61	$24.30	$47.31	$44.17	$18.55	$2.23		
Q4 Tax Rate	24.40%	24.90%	23.50%	27.10%	25.40%	25.00%		
LTM Pre-Tax Income per Share	$59.01	$32.36	$61.84	$60.59	$24.87	$2.97	$40.27	
2022 Blue Sky Multiple	3.57x	3.39x	2.85x	2.24x	3.87x	14.09x	5.00x	3.48x
FWD Earnings per Share	$32.76	$22.00	$44.05	$39.02	$17.01	$8.56		
FWD Pre-Tax Income per Share	$43.34	$29.30	$57.58	$53.53	$22.80	$11.41	$36.33	
2022 Blue Sky Multiple	4.86x	3.74x	3.06x	2.53x	4.22x	3.67x	3.68x	3.71x
3-Year Avg. Pre-Tax Income per Share	$37.16	$20.82	$42.54	$45.84	$17.95	$4.04	$28.06	
3-Year Average Blue Sky Multiple	5.67x	5.26x	4.14x	2.96x	5.36x	10.36x	5.63x	5.31x

Source: S&P Capital IQ Pro

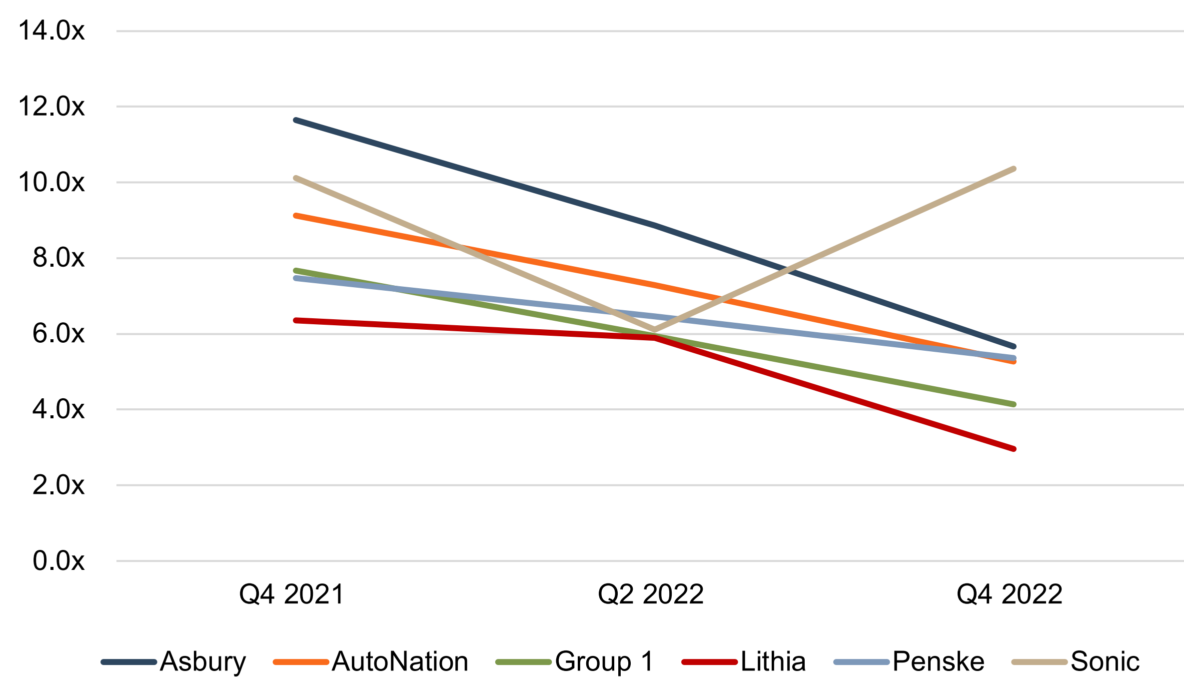
Guidline Public Company Analysis

As of Year-End 2022

Blue Sky Multiples (cont.)

As seen in the graph, public auto dealer multiples have generally declined over the past year. However, 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 Lithia is near the bottom). Penske was closer to Group 1 last year but is now closer in line with AutoNation. Sonic is also significantly higher due to the non-recurring impairment charge. We also see the limitations of this valuation metric when considering significant growth. With Lithia's significant acquisitions, 2020 earnings are not indicative of ongoing expectations. Further analysis is needed to make sense of these multiples rather than taking a simplistic average that may be more appropriate for a single point dealer.

Three Year Average Blue Sky Multiples



Source: Haig Partners

Guidline Public Company Analysis

As of Year-End 2022

Market Capitalization, Revenue, and Dealership Count

Public auto dealers saw their market caps decline by an average of 18.1% during 2022, which compares favorably to a 19.4% decline in the S&P 500 index during the same period. While all dealers saw their stock prices decline in the past 12 months (in line with the broader equity markets), performance was much more disparate over the past 6 months. Penske, Asbury and Sonic were up between 3.1% and 24.4% while Group 1, AutoNation, and Lithia, fell between 7.1% and 30%.

This mixed-bag performance in the second half of the year can be attributed to differences in growth strategies, prices paid for recent acquisitions, and business models/revenue mix between business segments, among other factors.

Over the past year, Asbury's revenue has grown by the most on a percentage basis. Revenue growth is due to acquisitions, as Asbury also saw the largest rooftop growth over the past year by adding 48 new stores and 74 new flags to its operations. Investors appear to like these acquisitions as the company's market cap is essentially flat for the year, compared to an average decline of 18.1% for the public automotive retailers.

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	$3,967	5.9%	-0.7%	$15,434	19.4%	56.9%	139	-10.3%
AutoNation, Inc.	AN	5,319	-18.4%	-30.5%	26,985	1.5%	4.4%	247	0.0%
Group 1 Automotive, Inc.	GPI	2,535	-7.1%	-25.7%	16,222	8.9%	20.3%	204	1.0%
Lithia Motors, Inc.	LAD	5,597	-29.6%	-37.7%	28,188	6.7%	23.5%	296	6.5%
Penske Automotive Group, Inc.	PAG	8,195	3.1%	-2.4%	27,815	4.3%	8.8%	338	5.6%
Sonic Automotive, Inc.	SAH	1,802	24.4%	-11.7%	14,001	5.9%	12.9%	111	0.9%
Average		**$4,569**	**-3.6%**	**-18.1%**	**$21,441**	**7.8%**	**21.1%**	**223**	**0.6%**
Median		**$4,643**	**-2.0%**	**-18.7%**	**$21,604**	**6.3%**	**16.6%**	**226**	**0.9%**

Guidline Public Company Analysis

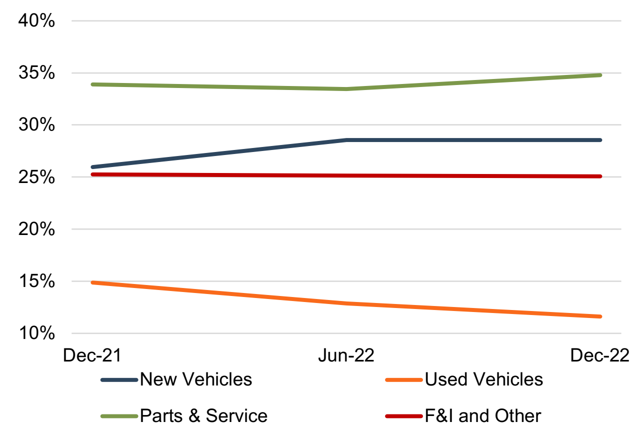
As of Year-End 2022

Gross Profit by Segment

Historically, parts and service departments have made the largest contribution to gross profit for the publicly traded dealers. While its contribution is below pre-pandemic proportions, modest declines in variables sales led fixed operations to contribute more to gross profit in 2022 than the prior year (as seen in the line graph on the right).

Gross profit from finance and insurance has remained stable as a percentage of total gross profit during the same period, as increased sticker prices on new and used vehicles led to proportionate increases in financing income. Higher priced vehicles makes insurance a more important consideration for vehicle buyers and in order to keep monthly payments affordable, vehicle loan terms have increased, which supports growth in financing income.

Average Gross Profit by Segment



Source: S&P Capital IQ Pro

New vehicle gross profit has increased and remained elevated as supply chain disruptions pushed new vehicle sticker prices to record highs throughout 2022. Used vehicle pricing was also elevated in late 2021 and into early 2022 while used vehicles helped satisfy the demand shortfall for new vehicles that simply were not available at the time. As new vehicle availability slowly improved during 2022, used vehicle prices dropped and gross profit from the segment fell as well. Used gross profit is also negatively impacted by declining used vehicle prices as dealers may have been caught with vehicles acquired at higher prices than that for which they could be sold.

Public Auto Dealers	New Vehicles	Used Vehicles	Parts & Service	F&I and Other	Total
Asbury Automotive Group, Inc.	27.2%	11.4%	37.2%	24.2%	100.0%
AutoNation, Inc.	26.0%	10.5%	36.1%	27.4%	100.0%
Group 1 Automotive, Inc.	27.8%	10.6%	37.2%	24.4%	100.0%
Lithia Motors, Inc.	30.7%	16.0%	28.4%	24.9%	100.0%
Penske Automotive Group, Inc.	30.8%	13.4%	35.6%	20.1%	100.0%
Sonic Automotive, Inc.	28.8%	7.7%	34.2%	29.3%	100.0%
Average	**28.6%**	**11.6%**	**34.8%**	**25.1%**	**100.0%**

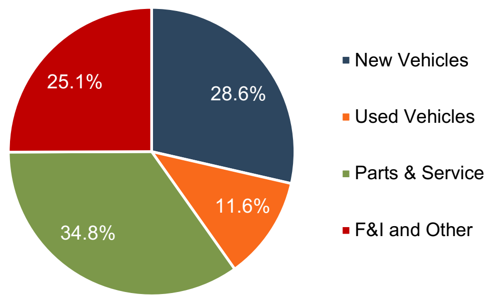
Guidline Public Company Analysis

As of Year-End 2022

Gross Profit by Segment (cont.)

New vehicle gross profit has increased and remained elevated as supply chain disruptions pushed new vehicle sticker prices to record highs throughout 2022. Used vehicle pricing was also elevated in late 2021 and into early 2022 while used vehicles helped satisfy the demand shortfall for new vehicles that simply were not available at the time. As new vehicle availability slowly improved during 2022, used vehicle prices dropped and gross profit from the segment fell as well. Used gross profit is also negatively impacted by declining used vehicle prices as dealers may have been caught with vehicles acquired at higher prices than that for which they could be sold.

Average Gross Profit by Segment



Source: S&P Capital IQ Pro

Sales Satisfaction Index

As of Year-End 2022

Every year, JD Power releases the **Sales Satisfaction Index ("SSI")** Study, measuring satisfaction with the sales experience among new-vehicle buyers and rejecters (defined as those who shop a dealership and purchase elsewhere). Buyer satisfaction is based on six measures: delivery process (26%), dealer personnel (24%), "working out the deal" (19%), paperwork completion (18%), dealership facility (10%), and dealership website (4%). Rejecter satisfaction is based on five measures: salesperson (40%), price (23%), facility (14%), variety of inventory (11%), and negotiation (12%). Scoring is based on a 1,000-point scale and the 2022 study is based on responses from nearly 37,000 buyers who purchased or leased their new vehicle from March-May 2022. Satisfaction of rejecters was measured from July-September 2022. Notably, customer satisfaction declined for the first time in more than 10 years, which J.D. Power attributed to low new vehicle inventory and high transaction prices.

Key Findings of the 2022 SSI Study

Elevated Sticker Prices Had A Significant Negative Effect On Overall Satisfaction

Despite the prevalence of inventory shortages and high sticker prices being commonplace, satisfaction among buyers and rejecters was lower when the asking price was over MSRP. The study showed that the average satisfaction score among buyers who paid more than MSRP was 757 while satisfaction among those who paid at MSRP or less was scored at 850. For perspective, 25% of buyers of mass market vehicles and 19% of buyers of premium vehicles paid more than MSRP in 2022.

Special Orders Were Positively Correlated With High Satisfaction Scores

The study found that satisfaction among buyers who special ordered their vehicle was scored at an average of 854. In contrast, buyers who bought their vehicle from a dealer's lot scored an average of 841. The magnitude of this effect is much less robust than the effect of higher sticker prices. However, it seems like pre-orders could be an attractive ongoing service for dealers and consumers moving forward. Once vehicle availability improves, we believe this gap in satisfaction will widen. Given significantly strained supply, we believe some shoppers may have been relieved just to be able to buy off the lot instead of having to wait numerous weeks, which may have inflated satisfaction scores.

Sales Satisfaction Index

As of Year-End 2022

EV Buyers Need Support As They Switch Powertrains

The study found that more than one-third (38%) of EV buyers failed to get instruction on charging their new vehicle before leaving the dealership. Overall satisfaction was scored at an average of 872 for luxury EV buyers that knew how to charge their vehicle after purchase compared to 709 for those who did not. Satisfaction was similarly affected for buyers of mass market EVs. Sometimes, it really is the simple things that get overlooked during the course of doing business.

Buyers Have Become More Comfortable With Digital Retailing

The lack of available inventory over the last year seemed to help buyers become more comfortable searching for their next vehicle online. In 2022, 85% of buyers said that they visited a dealership during the buying process. That number is down from 88% in 2021. While this change may not seem material at first, it is important to note that many who visited the dealership started their buying process online, which has not always been the case. For instance, 18% of buyers who visited the website of their selling brand or dealer say that they completed purchase paperwork online and 18% of buyers agreed to the final purchase price of their vehicle online.

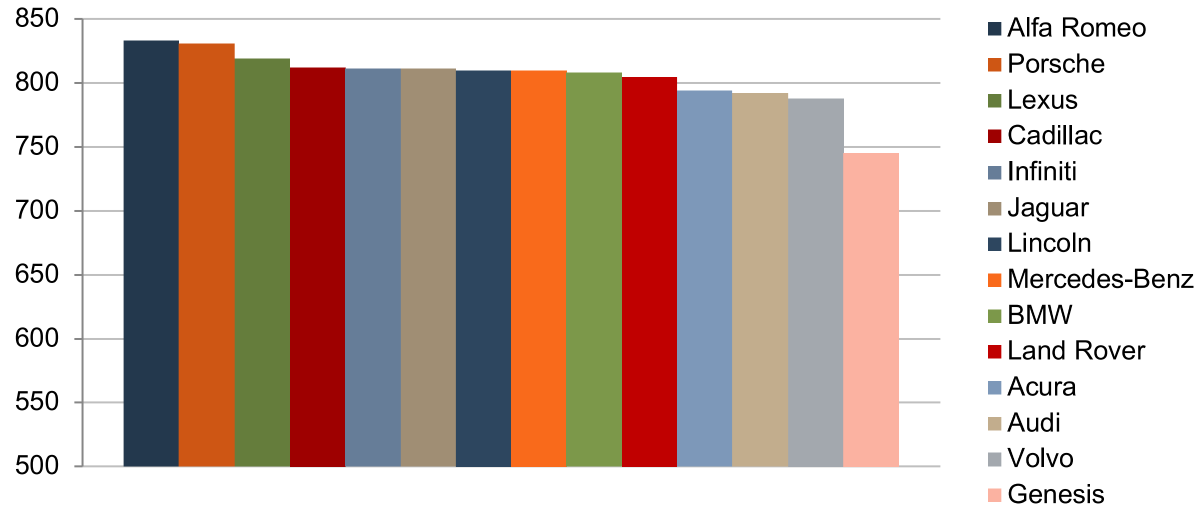
Sales Satisfaction Index

As of Year-End 2022

Luxury

The SSI rankings of luxury brands shifted quite a bit in the last year. Alfa Romeo and Porsche take the two top spots while Infiniti dropped three spots from 2nd to 5th. Alfa Romeo moved up the rankings eight spots in 2022, taking the top spot and marking the second year in a row that overall satisfaction increased for the brand after placing second to last in 2020. For the other luxury brands, movements were minimal in either direction and rankings remained largely the same on a relative basis with one another. While Genesis had the third best improvement in 2022, it still remains the lowest ranked luxury brand.

Sales Satisfaction Index (SSI) – Luxury



Source: JD Power

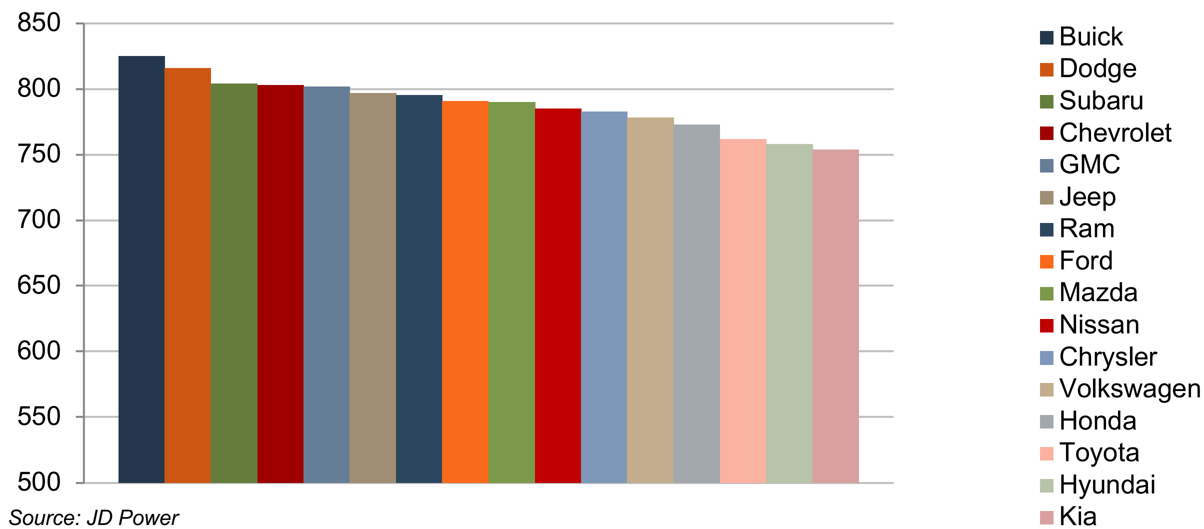
Sales Satisfaction Index

As of Year-End 2022

Mass Market

During 2022 the SSI rankings for mass market were more volatile that luxury brands. The top two spots in the 2022 rankings belong to Buick and Dodge, which were second and fourth last year, respectively. The largest improvement in satisfaction score came from Chrysler (28 point increase and up six spots in the rankings), while Honda saw the largest decline (19 points and down six spots in the rankings). Half of the 16 brands saw improvement, with an average increase of 14 points, while the other half of the brands saw an average decline of eight points.

Sales Satisfaction Index (SSI) – Mass Market



Source: JD Power

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 stores and related industry companies
- Transaction advisory for mergers, acquisitions and divestitures
- Litigation support for economic damages, shareholder disputes, tax related controversies, and family law and divorce.
- Family business advisory services for buy-sell agreements and estate planning.

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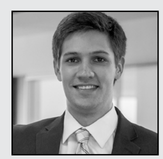

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