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VALUE FOCUS

Auto Dealer Industry

Issue No. 11 | Data as of Mid-Year 2023

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.

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FEATURE ARTICLE

Q2 2023 Earnings Calls

Lower New Vehicle Supply Boost Fails to Lift Profits; Used Vehicle Prices Drop Amid High Demand

Reviewing earnings calls from executives of the six publicly traded auto dealers, new vehicle gross profit declined as inventory availability improved, though the decline in profitability was less than anticipated. While unit-level profitability is anticipated to continue to decline, there are signs of strength in consumer demand. Despite affordability issues, the market is anticipated to remain structurally above pre-pandemic levels.

Improved new vehicle availability has led to declines in used vehicle prices as consumers are no longer forced to substitute from new to used. This new-used imbalance has so far outweighed what would be tailwinds to used vehicle profitability. Specifically, affordability has replaced supply constraints as the reason consumers are substituting for used vehicles, but constrained new vehicle supply in the past three years means the supply is much smaller for the desirable 1-4-year used segment. The reduced supply has a trickle-down effect, leading to an older average age of vehicles throughout the country, which points to pent-up demand for vehicles and fixed operations to service these older vehicles.

Let's flesh out the major themes from the Q2 2023 Public Auto Earnings Calls:

Theme 1: New Vehicle GPUs Moderated More Slowly Than Anticipated

As new vehicle inventories improved coming out of the supply chain issues, volumes were anticipated to increase, offset by declining profitability per unit. However, the decline in profitability has not happened as quickly as some expected due to pent-up demand. Public auto dealers also noted a fair amount of runway due to pent-up demand as presold vehicles and the number of vehicles sold at MSRP are still high, and lease penetration and incentives are still below historical levels.

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"Light vehicle sales remain below what most of us who've been in the business a long time would consider trend. Where industry incentives and lease penetration, even though they both have been increasing as late, they're still significantly below pre-pandemic levels, which I think just to give you an indication, OEMs still have a lot of additional tools to help spur demand if it's needed in the marketplace. […] Gross PVRs as expected, continue to mitigate, yet remains robust. […] Front-end margins have been more resilient than most of us were expecting heading into the year. Now I expect margins will continue to moderate partly to maintain current demand in this higher monthly payment environment and partly as inventory levels continue to increase and fewer vehicles are being sold at MSRP. However, I do not expect margins to return to pre-pandemic levels for the foreseeable future based on higher average selling prices of vehicles and continued lower industry inventory levels."

– Michael Manley, CEO, AutoNation

"Thus far in 2023, GPUs for new vehicles have come down approximately $100 per month, half of our original expectations. We remain focused on growth and profitability, and we look to gain further efficiencies across our businesses. […] I think in terms of looking forward on where we see GPUs going, I think we still are in the camp that GPUs will normalize. We still believe it's somewhere between $300 and $500 above pre-COVID levels."

– Bryan DeBoer, President and CEO, Lithia Motors

"*Most of the presold vehicles will be sold at or very close to MSRP. And you think about our luxury and import, almost 50% of the volume come from Lexus, Mercedes, Toyota, and Honda. All those brands, we have a low day supply. So, you could imagine that a lot of those vehicles are presold in those lines, which are going to garner high PVRs. […] To your point on the domestics, we're back to what I would call a normal day supply of domestic vehicles. […] We're not going back to '19 levels [of new vehicle GPU]."*

– David Hult, CEO, Asbury Automotive Group

"The industry continued to see improvement in new vehicle production and inventory levels which results in incremental new vehicle sales volume and lower new vehicle gross profit per unit sequentially as expected. This decline in new vehicle GPUs should continue as we progress through the second half of 2023 and into 2024, but we continue to believe that the new normal of new vehicle GPU will remain structurally higher than it was pre-pandemic."

– David Smith, CEO, Sonic Automotive

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"Looking at the presales in the US, I mean to us, that indicates a pretty healthy, strong consumer. Looking at the aftersales pull-through, we see evidence of a pretty strong consumer. We're seeing a little pressure in F&I, but it's just a little bit, honestly, I mean it's $100. I mean — so from a consumer perspective, we see good things there. And I don't know if that will change."

– Daryl Kenningham, President and CEO, Group 1 Automotive

Theme 2: Days' Supply Influenced by Brand, Model, and Potential Labor Strikes

There continues to be significant dispersion in days's supply by brand, as volume import brands have the lowest supply and domestics have the highest. When asked about a pending UAW strike, executives pointed out that domestics had the highest day supply, and the strike could ultimately be positive toward GPUs.

"As is the case with the overall industry, we have a wide dispersion of inventory levels by brand and model. In core brands are generally below the company average, domestic brands generally above and premium luxury generally in line with the average. The overall new vehicle market remained healthy during the quarter as almost 40% of our vehicles were sold at MSRP, which continues to be far higher than pre-pandemic levels. This is down from about 45% in Q1."

– Joe Lower, CFO, AutoNation

"Consistent with our comments on inventory last quarter, our domestic brands have improved slightly and import brands have remained very constrained. Approximately, 28% of our US business is Toyota and Lexus, which continues to be very tight at a combined five-day supply."

– Daryl Kenningham, President and CEO, Group 1 Automotive

"Whether that is a strike or prolonged strike, or they get to an agreement beforehand, I don't know. But what I can tell you is if you look at the inventory development, the biggest growth in inventory that we've had is in our domestic. That to me gives me a level of comfort. [...]We still only have 43 days of the domestic. I have to say embarrassingly in my time, we were up at 130. So, when we talk about build, I think we still have to remind ourselves and ground ourselves that particularly for the domestics, high levels of inventory, spot deliveries is what most of the customers are used to and expect in those businesses. So yes, we are talking about a build, but we're only at 43 days."

– Michael Manley, CEO, AutoNation

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"That UAW strike, it could help stabilize our margins, which is quite nice. It may be part of the reason why I may hedge a little bit of that $100 declines. If we do get that strike with certain manufacturers, it could be a nice thing to help stabilize those GPUs for a little bit longer."

– Bryan DeBoer, President and CEO, Lithia Motors

"The inventory question is hard to answer only because when you look at an average day supply, the split on that goes from a six-day supply on a mainline import and then an 83-day supply on a large domestic. And so what it is, is the gives and the takes between all the Ms that make an average. But what we do know is the lower priced vehicles that are affordable for consumers and the affordability is a big piece of this that are on the ground are turning faster than heavy content vehicles and more expensive vehicles. […] And so the GPUs kind of follow the general trends that you're seeing based on supply and demand. And so more inventory generally means more discounting and we're kind of watching it out."

– Chris Holzshu, EVP & COO, Lithia Motors

Theme 3: Volatile Used Vehicle Prices Declined Since March

When new vehicle production declined, consumers were forced to turn to used vehicles, causing used vehicle prices to appreciate at a faster rate than new vehicles. The unwinding of this unsustainable price difference between new and used vehicles is the primary reason for the price decline. However, used vehicle prices remain volatile, requiring either conservative purchasing or exposure to sharp declines in market values. Since vehicle affordability is a key concern for many buyers, used vehicle prices have declined to balance higher payments from rising interest rates.

"Same-store used vehicle revenues were down 15.8%, driven by unit volumes declining 11.6% and ASPs decreasing 4.7%. The recent decline in used car prices is a result of higher interest rates and gradual pace of new vehicle inventory improving."

– Chris Holzshu, EVP & COO, Lithia Motors

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Lower New Vehicle Supply Boost Fails to Lift Profits; Used Vehicle Prices Drop Amid High Demand

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"We know everybody is trying to get zero to four-year used vehicles, and that's still going to be tight, because they have less trades on vehicles over new vehicle sales over the last say, 18 months. They were all fishing in the zero to four times. And we had a number of lease returns that didn't come back during that period due to customers buying out or extending leases. So, what I see is probably the cost of sales going down in the market. But on the other hand, I think we can maintain our grosses, because we're going to stay in the zero to four-year timeframe, we've done that in the past, and hopefully, when we look at the opportunity here, we'll get some cars coming off lease, which before obviously, we're going to customers who are buying those."

– Roger Penske, Chairman and CEO, Penske Automotive

"In the used vehicle business, wholesale auction prices for three-year-old vehicles decreased 6% in the second quarter, unwinding the surprise increase we saw in the first quarter. And this is important. July month-to-date, three-year-old wholesale prices are down nearly 4%, consistent with our expectations for continued price normalization in the third and fourth quarters, which will ultimately benefit consumer affordability and demand for used vehicles once retail pricing follows the wholesale trend in the same directions. […] We mentioned it earlier. I mean it was from all accounts a historic drop in valuations in the used car market. So we think strategically, it's really smart to keep that inventory tight. And as Jeff said, maybe miss a few retail deals until that market starts to flatten out more consistently and then we can crank up the volume."

– David Smith, CEO, Sonic Automotive

"New car inventory across the board from everybody's announcements is going up from a day supply perspective. No sales in the auction lanes are real high, north of 50% right now, which is a good sign that inventory is building and prices are going to come down. So there's going to be more volume to buy [with] the rental car companies pretty much now out of the lanes from buying cars, and that's what really caused a big issue in March for us and for the industry."

– Jeff Dyke, President, Sonic Automotive

Theme 4: Opportunities and Challenges from Aging Vehicles

With three years of depressed new vehicle volumes, there are both opportunities and challenges for auto dealerships. Older vehicles portend pent-up demand for vehicle sales and require more maintenance. Lower sales velocity for new vehicles also reduced trade-in opportunities — a key sourcing mechanism for used vehicle sales.

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"There obviously continues to be mixed economic signals in the overall economy. But from our point of view, the supply and demand equation, even though it is moderating, we think, has remained favorable for the business. And last quarter, I said that we thought the consumer in no way tapped out, and we still feel that's the case for sure. Now notwithstanding the fact that higher interest rates are impacting affordability, lower unit sales over the past few years have contributed to pent-up demand, which, as we see inventory levels improve and some mitigation on that transaction price continue to convert to sales in the marketplace. And the aging vehicle part, which is now about 12.5 years as well as positive household formation, I think, are additional favorable dynamics for the business. And these factors, I think, will continue to be a benefit for new and used vehicle sales going forward."

– Michael Manley, CEO, AutoNation

"The US car park lost approximately 8 million units during their production declines in the COVID pandemic, which will provide years of demand tailwinds for used vehicle inventory. This scenario again highlights the benefits of being a top of funnel new car dealer were accessed to customer trades and off-lease products from our partner OEMs is a massive differentiator as it represents over 75% of our used vehicle sales."

– Chris Holzshu, EVP & COO, Lithia Motors

"We are optimistic about the future of automotive retail. We operate in an environment where the average age of our car is 12.5 years, the highest it's ever been. While SAAR levels have been trending higher, they are still well below historical levels. The combination of older cars, complexity of new cars and the transition to EVs enables consistent growth within our parts and service business."

– David Hult, CEO, Asbury Automotive Group

"I think the game is turning to throughput again here in the future. And a lot of our focus and efforts will be towards that. And we still see a lot of demand out there. Carpark is still really aged. There's still a lot of repairs to be done on vehicles that have been — that are older units, older vehicles. And — so I believe that there's still — the outlook is for parts and service is still bright, it's really bright, still opportunistic."

– Daryl Kenningham, President and CEO, Group 1 Automotive

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Tidbits of Note

As usual, we found a few other tidbits of interest for our auto dealer clients, which aren't included as trends because they were only mentioned by one of the public companies. This quarter, we note comments by Lithia about stock compensation, AutoNation about dealership size, and Asbury about EV RO's.

Stock Compensation

Lithia was asked about its GM incentive program — Lithia Partners Group, or "LPG" — and its impact on the company. Lithia CEO Bryan DeBoer noted that GMs in the LPG get twice as much ownership in Lithia stock, along with other perks incentivizing the GMs to manage the store as if they owned it.

We've seen numerous cases of clients giving/selling equity interests ranging from 5-25%, which is similar but also comes with fewer issues when a GM leaves a privately held store, frequently necessitating a valuation of their ownership interest.

Dealership Size

When discussing fixed operations capacity, AutoNation CEO Michael Manley noted that OEMs have oversized their dealerships for many years. While OEMs and dealers might wish they could snap their fingers and fundamentally change the size and locations of dealerships as they stand today in a post-COVID environment, the switching costs are too high for this to occur en masse.

The industry appears to be generally consolidating, but this is more about the number of owners rather than a decline in the number of dealerships.

Aside from dealers monetizing their land in growing metropolitan areas, there likely won't be a material change to where dealerships are located and how big they are. Smaller dealerships would reduce costs and might enable finding more convenient locations to increase fixed operations market share.

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EV Repair Orders

With the transition to electric vehicles, proponents have consistently pointed to lower maintenance costs offsetting higher upfront vehicle purchase costs, in addition to environmental benefits. While strides have been made to reduce the upfront cost, the anticipated maintenance expense decline may not have a dollar-for-dollar adverse impact on auto dealers.

Asbury SVP Daniel Clara indicated that the average repair order of BEVs was 1.5x that of ICE vehicles.

If auto dealers can price these repairs more advantageously and capture greater market share with customers trusting technicians specially trained for EVs, the future decline in this part of the business may have been overstated.

Conclusion

At Mercer Capital, we follow the auto industry closely to stay current with trends in the marketplace. These give insight into the market for a private dealership, which informs our valuation engagements. To understand how the above themes may impact your business, contact a professional at Mercer Capital to discuss your needs in confidence.

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FEATURE ARTICLE

Mid-Year 2023 Review of the Auto Dealer Industry by Metrics

Cooling Statistics, But Perspective Is Key

The first half of 2023 is fully in the rearview mirror, and mid-year statistics for the auto industry have been released. How has the industry performed, and what do the metrics tell us about the direction the industry is headed for the remainder of 2023? In this post, we discuss several key metrics that we have tracked in this space over the last several years: 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 tempered due to high transaction prices and high interest rates, incentives offered by manufacturers have increased over the first half of the year, and vehicle supply continues to improve. But has this metric peaked? The chart on the next page, created with elements provided by the **JD Power and LMC Automotive forecast**, illustrates the current and historical estimates have declined since the year-end high-water mark of $5,258 in December 2021. While these figures have cooled in recent months, the June 2023 figure of $3,692 per new vehicle unit is more than 1.5x the margin that dealers were experiencing in December 2020 and almost three times the margin realized in December 2019.

For context, JD Power reports that 30% of new vehicles sold above MSRP in June 2023, compared to 50% of new vehicles selling above MSRP this time last year. If these trends continue along with increased incentives from manufacturers, average transaction prices for new vehicles will cool slightly for the remainder of 2023 despite inflation and increased input costs for the OEMs.

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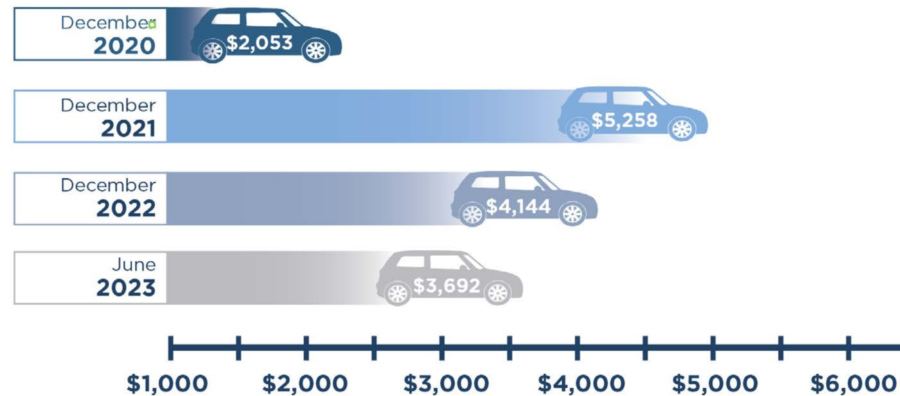

I recently listened to an industry webinar that described current market conditions for the auto industry. The auto dealer audience was polled throughout the webinar about their expectations about various metrics. When asked about their expectations for new vehicle profits for the remainder of the year, most responded that they expected profits to decline 10-15% from year-end 2022 figures. For perspective, even if new vehicle profits fell by 25% from year-end 2022 levels, new vehicle profits would still be 2.5x pre-pandemic figures.

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 in this space on numerous occasions. We've also viewed this trend from a similar metric measuring the average time in days that 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 28 days as of December 2022 and June 2023, respectively. Both figures indicate a steady climb and slight improvement over the prior-year-end low of 17 days in December 2021. While most experts are cautiously optimistic that the auto OEMs will not revert to the historical levels of production and inventory, the graphic on the next page shows the context of the latest two figures to historical year-end figures:

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Cooling Statistics, But Perspective Is Key

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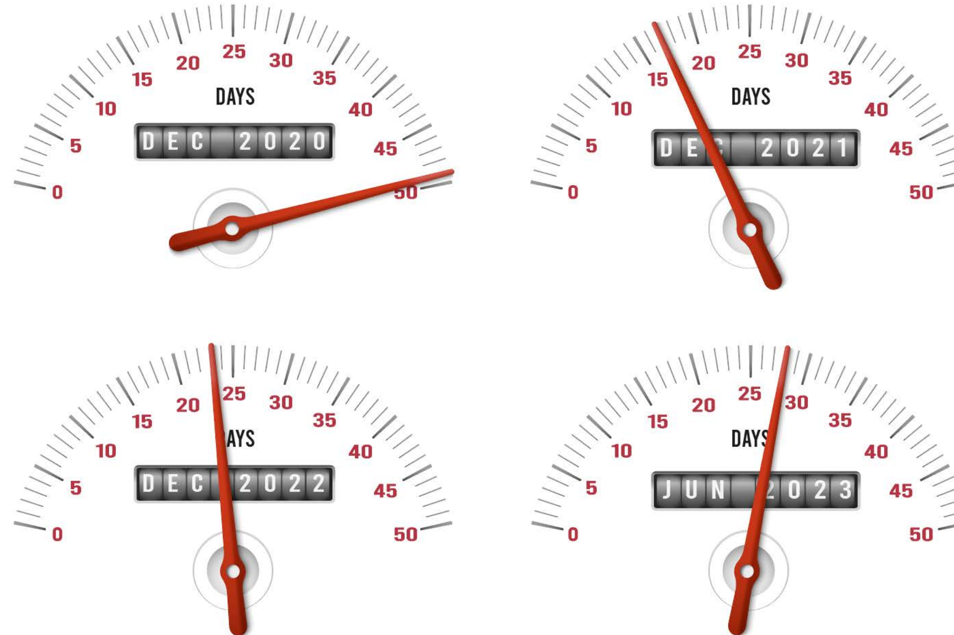
Average Time New Vehicle on Dealer's Lot



Source: JD Power - LMC Automotive Monthly Forecasts

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 46% 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 but level with the percentage that dealers were experiencing at year-end 2022.

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Cooling Statistics, But Perspective Is Key

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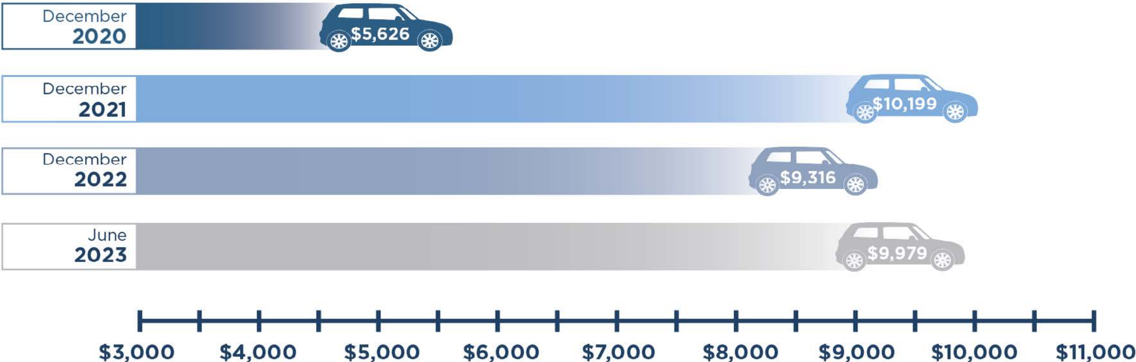
Average Trade-in Equity Used Vehicles

Like new vehicles, used vehicle transaction prices also soared during 2022 but have cooled some in recent months. 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. Unlike other trends, the average trade-in equity value for used vehicles has climbed from year-end and early figures in 2023. According to the monthly forecasts from JD Power/LMC Automotive, the average trade-in equity value totaled $9,979 for June 2023 compared to $9,316 in December 2022.



With rising interest rates, consumers tend to focus more on their monthly payments. Despite average used vehicle transaction prices cooling slightly off record highs, we anticipate many consumers will choose to hold on to their vehicles longer during this time.

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Mid-Year 2023 Review of the Auto Dealer Industry by Metrics

Cooling Statistics, But Perspective Is Key

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

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

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

Historically, the gap between profits per unit earned on used and new vehicles was wider. For several years, auto dealers have made 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, average transaction prices for new and used vehicles have cooled slightly in the first half of 2023. With those conditions and the continued improvement in new vehicle supply in 2023, we expect the ratio of used to new vehicles to begin 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 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. This would benefit the auto dealer's fixed operations 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.

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Mid-Year 2023 Review of the Auto Dealer Industry by Metrics

Cooling Statistics, But Perspective Is Key

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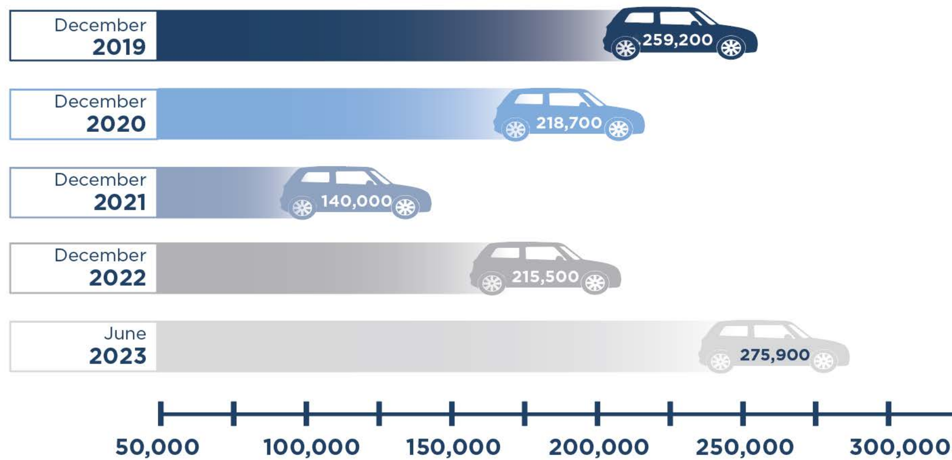
During the height of the pandemic, fleet sales declined significantly. Rental car companies weren't just canceling orders; they actively sold off their existing fleet to build up cash as cities endured temporary shutdowns and much of domestic travel was halted or significantly curbed. With travel returning and inventory supply improving, fleet sales are also steadily increasing. As seen in the graphic below, monthly fleet sales for June 2023 are estimated to be 275,900 units, the highest in the figures measured in the graph below:



Source: JD Power - LMC Automotive Monthly Forecasts

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 when they are driven more frequently or for longer distances. Increased miles will also lead to the eventual purchase of a new vehicle from either 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 on the next page.

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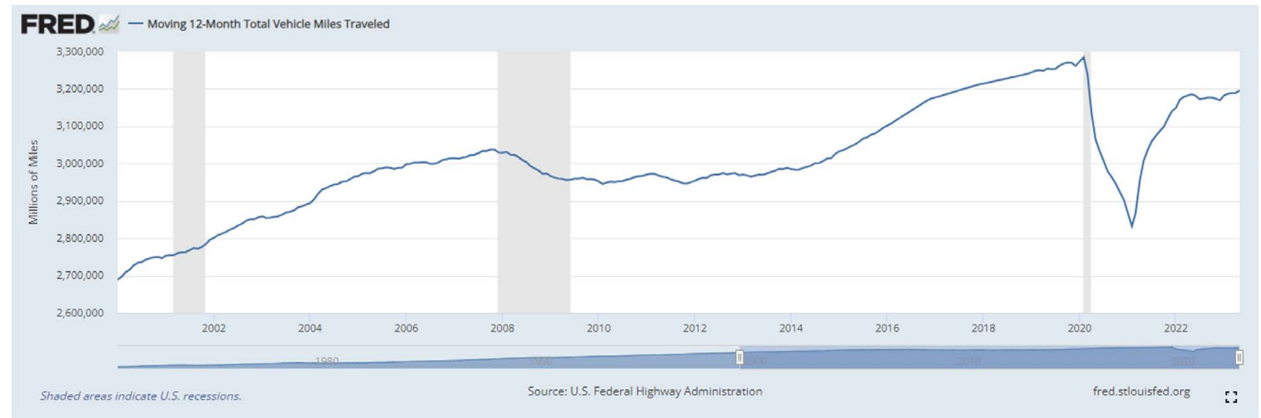

Over time, VMT has generally increased as the population has grown and more vehicles have been serviced. Since 1971, there have only been a few occasions where the rolling-12 month average has declined, which, as you'll note, tend to correlate with recessions: 1974, brief periods in the late 1970s and 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 below 2.8 trillion for the first time since the early 2000s. 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 has the rolling-12-month average fared in the first half of 2023? Vehicle miles traveled have actually remained fairly flat since May 2022, with a slight decline in the winter months of 2022. Perhaps this indicates the impacts following the great resignation and the increased number of workers working remotely full-time or part-time. Those workers have many fewer commuting miles 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 new and used vehicle sale profits are normalizing, as the service and parts department has historically performed as one of the highest profit centers in the overall dealership.

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Cooling Statistics, But Perspective Is Key

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Conclusion

The first half of 2023 marked another very successful period for auto dealers. Most metrics have peaked off record highs and continued to decline or cool slightly. While this could appear as a doom and gloom prediction following the record years experienced by most auto dealers in 2021 and 2022, it's all a matter of perspective. Despite cooling metrics in 2023, most key indicators are still well above pre-pandemic levels and, in most cases, in the magnitude of 1.5x-2.5x 2019 figures.

For an understanding of how your dealership is performing, along with an indication of what your dealership is worth, contact a professional at Mercer Capital to perform a valuation or analysis.

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

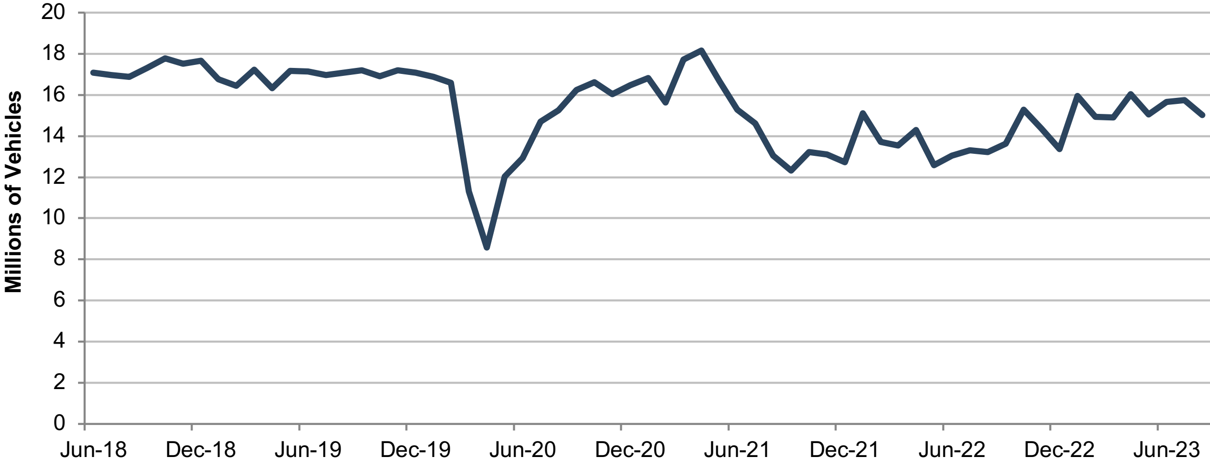
As of Mid-Year 2023

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 15.7 million units in June 2023, up 20.2% from 13.0 million units last June. This June marks the 11th straight month of year-over-year improvements in the SAAR, and the magnitude of the improvements has been growing over the last several months.

A year ago in June 2022, inventory levels were still dismal. The reported SAAR for three straight months was below 13.3 million units during June, July, and August of 2022. Inventory started to improve in August, and sales numbers followed suit in September, sending the industry on the path to recovery. With this context in mind, we expect to see large year-over-year increases in the SAAR going forward until late 2023.

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



Source: St. Louis Fed

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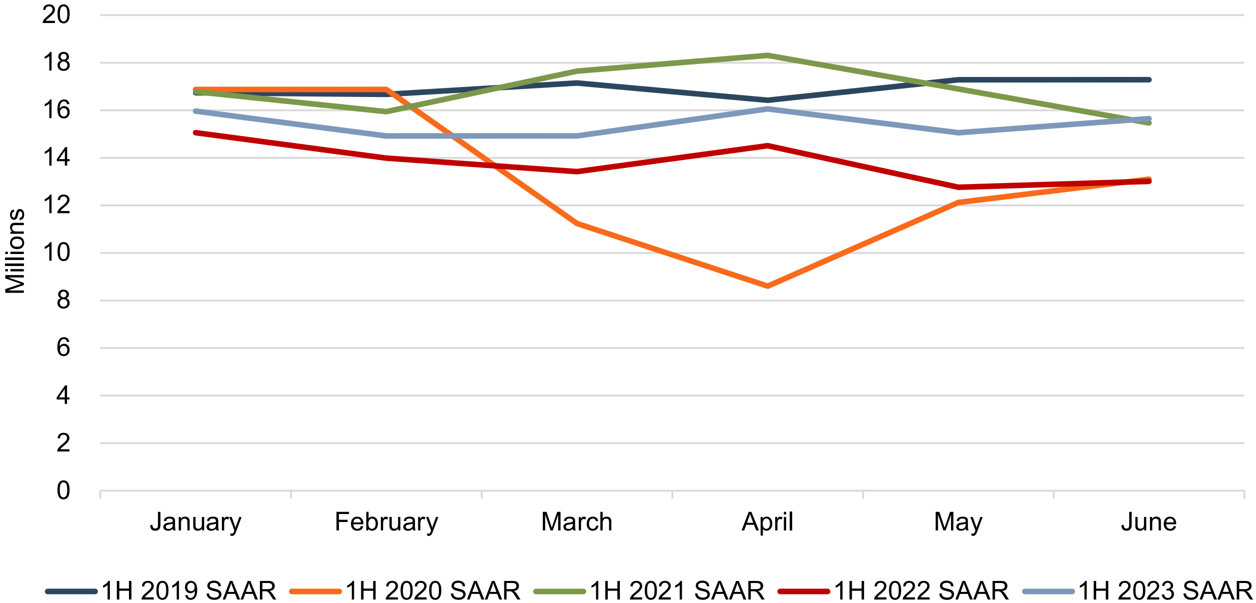
Light Weight Vehicle Sales: Autos and Light Trucks (SAAR)

As of Mid-Year 2023

As everyone knows, there are combatting forces in the sales equation: supply and demand. For a long time, inventory constraints crimped supply, leading to higher near-term profits for dealers. While many were asking when inventory shortages would end, the better question might be: "What would the demand side look like once supply improves?" Over the second half of 2023, we expect to gain more clarity on pent-up demand and how sales will respond to improved vehicle availability, though industry executives are still indicating that demand has not waned.

The chart below compares the SAAR during the first half of the last five years. For the previous six months in 2023, the SAAR has been higher than it was reported in a volume-depressed 2022 and a COVID-19-affected 2020. However, sales volumes have not fully recovered to pre-pandemic levels (see 1H 2019) and are certainly not as high as the red-hot 1H 2021. So while 2023 represents an improvement, there is still a runway for further recovery, as we sit well below the 17 million SAAR seen from 2014-2019.

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



Source. St. Louis Fed

Blue Sky Multiples

As of Mid-Year 2023

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. Since 2022, Haig Partners presented a multiple range for all dealerships given profitability across all brands.

Blue Sky multiples declined across all brands in Q1 2020 but had at least rebounded to neutral if not above by Q3 2020 once the uncertainty of the COVID-19 economic impact subsided and dealerships clearly began to benefit from the change in operating environment. Into 2021 and 2022, earnings became significantly more volatile due to supply chain constraints, though this volatility was typically to the upside for dealers. According to Haig Partners, Blue Sky multiples weren't moving as much as buyers' opinions on what "normalized" earnings would look like – whenever that was to occur.

While Blue Sky values have declined in 2023, this is due to earnings normalization rather than valuation multiples, as Haig notes that public auto dealers saw an 18% decline in earnings in the first half of 2023 compared to the prior year caused primarily by rising floor plan costs and reduced per-unit profitability as a result of increasing inventories. Earnings are expected to continue to fall as Haig cautions against applying their Blue Sky multiple ranges against current earnings. While Haig estimates average Blue Sky values have declined 7.3% from year-end 2022, though they remain 2.5x higher than 2019 levels. Higher borrowing costs are also reducing the purchasing power of would-be acquirers, though dealers are still willing to pay up for the right deal.

Blue Sky Multiples

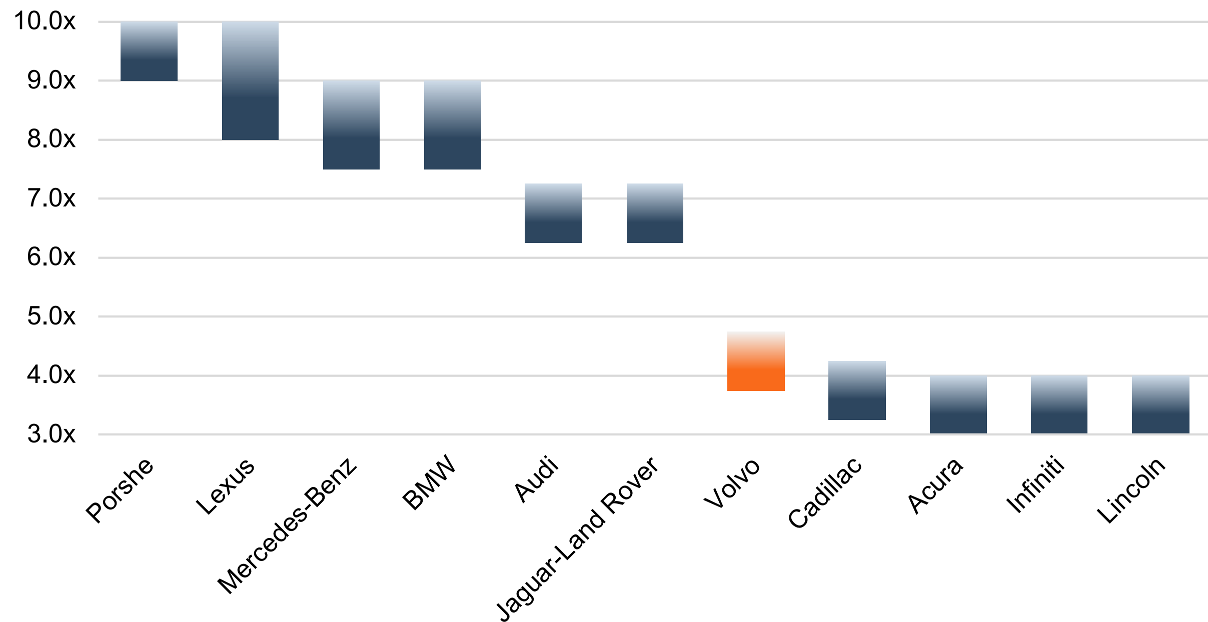
As of Mid-Year 2023

Luxury Blue Sky Multiples

At the high end of luxury, there has been no change in Blue Sky multiples in nearly 3 years.

Less valuable luxury brands returned to profitability. Given record profits in the past few years, three brands (Cadillac, Infiniti, and Lincoln) saw a return to a reported multiple rather than an estimated range of values. Cadillac got an additional bump in Q1 2023 edging ahead of Infiniti and Lincoln, but despite being luxury brands, these dealerships still change hands at lower Blue Sky multiples than domestics. It's likely related that Cadillac and Lincoln are owned by domestic OEMs GM and Ford, respectively. For the first time since Q1 2020, a brand saw a downgrade in its Blue Sky range with Volvo declining modestly, though it remains at the top of the bottom tier of luxury dealerships.

Luxury Blue Sky Multiples Range



Source: Haig Partners

** Orange indicates a decrease in the multiple from the previous quarter*

Blue Sky Multiples

As of Mid-Year 2023

Import Blue Sky Multiples

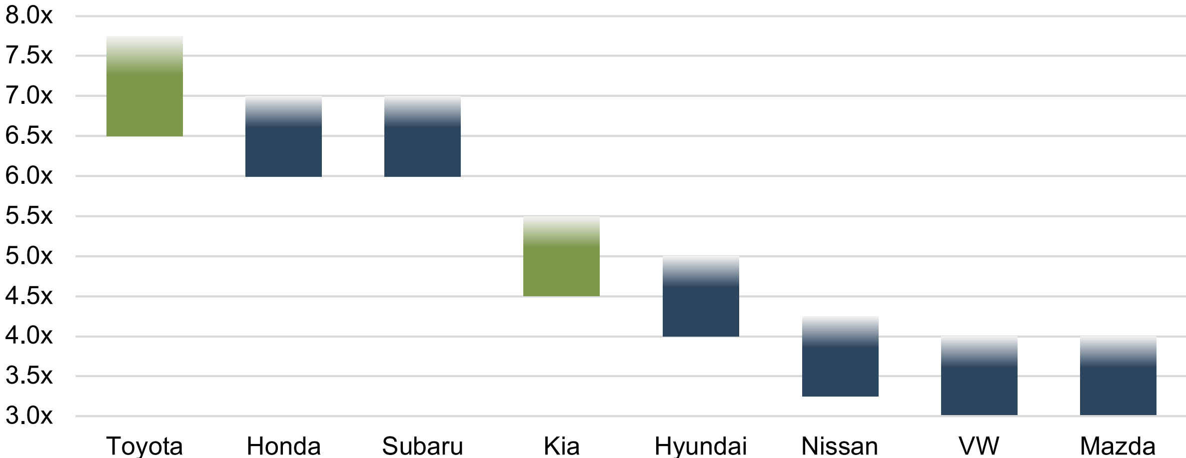
In the nine quarters from Q4 2020 to Q4 2022, there were eight increases to Blue Sky multiple ranges spread across only four brands – all of which were imports (Kia upgraded three times, Toyota and Hyundai twice, and Nissan), or an average of just under one change per quarter. While there were no changes in Q2 2023, Q1 saw three more upgrades to familiar faces: Kia, Toyota, and Cadillac.

Beginning in Q3 2021, Hyundai and Kia have been pulling away from the lower end of the mid-line import brands, creating three tiers:

- Average Blue Sky multiples of 6.5x or above: Toyota, Honda, and Subaru
- Average Blue Sky Multiples between 4x-5x: Hyundai and Kia
- Average Blue Sky multiples below 4x: Nissan, VW, and Mazda

Despite the improvement, Hyundai and Kia still have a long way to go to catch up to Subaru, Honda, and certainly Toyota, who has been a continuous riser.

Import Blue Sky Multiples Range



Source: Haig Partners

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

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Blue Sky Multiples

As of Mid-Year 2023

Domestic Blue Sky Multiples

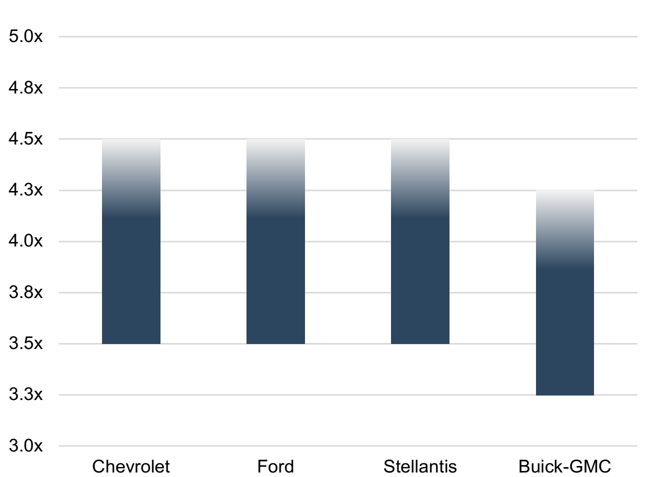
Domestic franchise multiples have not changed since Q3 2020. With the rise of Hyundai and Kia's multiples over the past year and a half, domestic brands' multiples are now generally in between the second and third tier of mid-line imports, where they once held a slight advantage over some of those brands. The lowest tier of luxury is also within this range with Volvo trending back towards the domestics.

Ford dealers have seen EV inventories rise faster than those of ICE vehicles. Ford has been the most vocal about significant investments by dealers in order to sell electric vehicles, though costs have not been as significant as initially announced by the OEM. A trend noted by Haig that may pertain to other domestic dealers is that buyer interest is low for Ford stores in smaller, more rural markets due to the cost of EV investments and limited allocations/market appetite. Acquirers have to be prudent in their brand mix to avoid the ire of OEMs, as this naturally creates a dichotomy between the multiples between metro and rural dealerships, the former of which having higher earnings, higher allocation, and likely more opportunities to add additional rooftops within the same market.

Stellantis' four well known brands (Chrysler, Dodge, Jeep and Ram) have the highest days' supply of all franchises, though this may be due in part to the anticipated UAW strike, which could reduce inventory builds for dealers.

While Chevy is on the opposite end of the spectrum, it's still seeing significant sales growth with some models doubling the prior year's volumes. This sales performance has been true for all GM brands, as Buick-GMC led sales volumes in Q2 2023. Given its slight discount to the other domestics, Buick-GMC is a brand to keep an eye on after numerous dealers opted to sell their franchise back to the OEM.

Domestic Blue Sky Multiples Range



Source: Haig Partners

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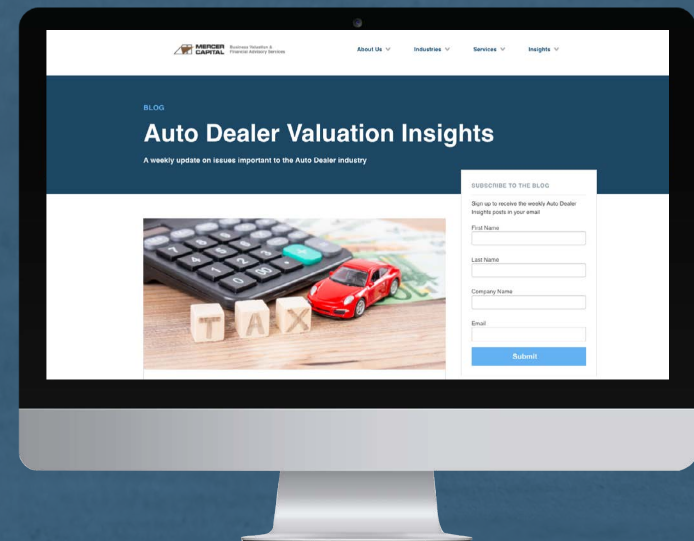


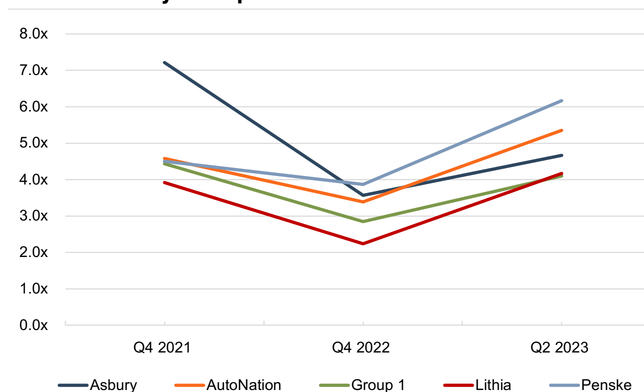
Guidline Public Company Analysis

As of Mid-Year 2023

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 (4.9x) is up considerably from the 3.2x seen at year-end 2022, indicating a recovery in valuations. Stock prices improved (as noted previously) while earnings normalized. This recovery is shown in the clear trend in the chart on the right. Asbury's multiple went from an outlier in 2021 to middle of the pack at mid-year 2023, while Penske became the highest valued on a pre-tax multiple basis.



Source: Haig Partners

Implied Blue Sky Multiples	Asbury	AutoNation	Group 1	Lithia	Penske	Average	Median
Stock Price	$240.42	$164.61	$258.10	$304.11	$166.63		
less: Tang. Book Value per Share	$25.03	$6.93	($6.46)	($77.43)	($21.61)		
Implied Blue Sky per Share	$265.45	$171.54	$251.64	$226.68	$145.02		
LTM Pre-Tax Income per Share	$56.86	$32.07	$61.43	$54.41	$23.52	$45.66	
LTM Q2 2023 Blue Sky Multiple	4.67x	5.35x	4.10x	4.17x	6.17x	4.89x	4.67x
FWD Pre-Tax Income per Share	$41.39	$28.35	$54.02	$46.42	$20.97	$38.23	
FWD Q2 2023 Blue Sky Multiple	6.41x	6.05x	4.66x	4.88x	6.92x	5.78x	6.05x
3-Year Avg. Pre-Tax Income per Share	$50.30	$29.58	$56.35	$54.71	$22.78	$42.74	
3-Year Average Blue Sky Multiple	5.28x	5.80x	4.47x	4.14x	6.37x	5.21x	5.28x

Source: S&P Capital IQ Pro

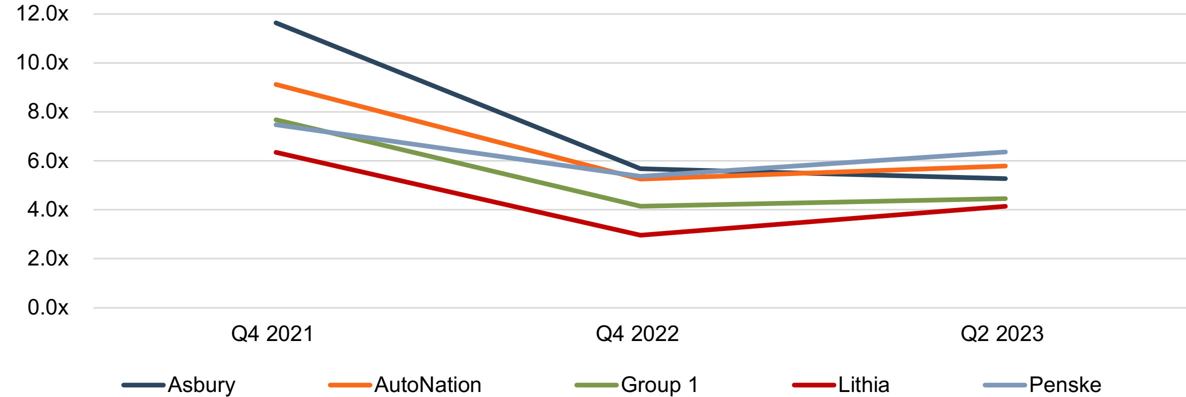
Guidline Public Company Analysis

As of Mid-Year 2023

Blue Sky Multiples (cont.)

Using a 3-year average methodology instead, Blue Sky multiples rise at a much more moderate rate as earnings normalization is still averaged with two years of outperformance. As discussed elsewhere in the newsletter, earnings are anticipated to decline going forward, which leads FWD Blue Sky multiples (5.8x) 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.

Three-Year Average Blue Sky Multiples



Source: Haig Partners

Guideline Public Company Analysis

As of Mid-Year 2023

Market Capitalization, Revenue, and Dealership Count

Public auto dealers saw their market caps increase by an average of 24.9% in the last twelve months, which compares favorably to a 17.6% increase in the S&P 500 index during the same period. While all dealers saw their stock prices rise in the past 12 months, performance has been dispersed as Lithia's stock rose only 5.3% compared to a 44.7% rise in Penske's stock. In the first half of 2023, all auto retailer stocks have rebounded by 30-50% with the exception of Sonic, which has fallen by 6.3%.

Over the past year, Asbury's revenue has grown by the most on a percentage basis (15.3%), but in the past six months, it has declined the most (-3.5%). In the first half of 2022, the company divested eight franchises, though it bought seven more. While Lithia has netted the most growth, Asbury has been one of the most active retailers in managing their dealership portfolio in part due to necessary changes following large acquisitions. Asbury remains the second smallest of the public dealerships by revenue and dealership count (Sonic is the smaller by all metrics), though it has a higher market cap than Group 1.

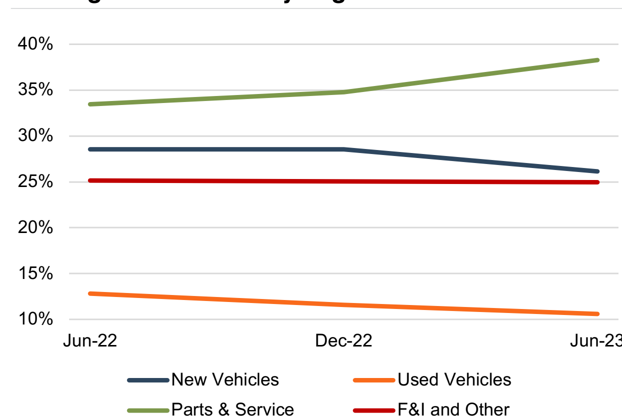
Public Auto Dealers	Ticker	Market Capitalization	6 Mo. Change in Market Cap	12 Mo. Change in Market Cap	LTM Revenue	6 Mo. Change in Revenue	12 Mo. Change in Revenue	Dealership Count	12 Mo. Change in Dealerships
Asbury Automotive Group, Inc.	ABG	$5,177	30.5%	38.1%	$14,897	-3.5%	15.3%	138	-6.8%
AutoNation, Inc.	AN	7,508	41.1%	15.2%	26,652	-1.2%	0.3%	253	2.4%
Group 1 Automotive, Inc.	GPI	3,542	39.7%	29.8%	16,921	4.3%	13.6%	150	2.7%
Lithia Motors, Inc.	LAD	8,371	49.6%	5.3%	29,333	4.1%	11.0%	345	18.2%
Penske Automotive Group, Inc.	PAG	11,498	40.3%	44.7%	28,740	3.3%	7.7%	337	1.5%
Sonic Automotive, Inc.	SAH	1,688	-6.3%	16.5%	14,183	1.3%	7.3%	108	-2.7%
Average		**$6,297**	**32.5%**	**24.9%**	**$21,788**	**1.4%**	**9.2%**	**222**	**2.6%**
Median		**$6,342**	**40.0%**	**23.1%**	**$21,786**	**2.3%**	**9.4%**	**202**	**2.0%**

Guidline Public Company Analysis

As of Mid-Year 2023

Gross Profit by Segment

As has historically been the case, parts and service departments have made the largest contribution to gross profit for publicly traded dealers. While this profit center's contribution is below pre-pandemic proportions, modest declines in variables sales led fixed operations to contribute more to gross profit in the past twelve months. 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 make insurance a more important consideration for vehicle buyers. And, in order to keep monthly payments affordable, increasing interest rates and vehicle loan terms have supported growth in financing income.



Source: SEC Filings

Public Auto Dealers	New Vehicles	Used Vehicles	Parts & Service	F&I and Other	Total
Asbury Automotive Group, Inc.	25.8%	10.5%	40.7%	22.9%	100.0%
AutoNation, Inc.	21.9%	11.0%	40.2%	26.9%	100.0%
Group 1 Automotive, Inc.	25.8%	10.5%	40.0%	23.6%	100.0%
Lithia Motors, Inc.	27.8%	14.4%	32.3%	25.5%	100.0%
Penske Automotive Group, Inc	30.5%	11.5%	38.0%	20.0%	100.0%
Sonic Automotive, Inc.	25.1%	5.7%	38.6%	30.6%	100.0%
Average	**26.2%**	**10.6%**	**38.3%**	**24.9%**	**100.0%**

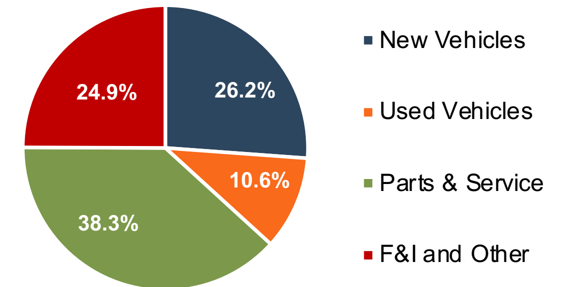
Guidline Public Company Analysis

As of Mid-Year 2023

Gross Profit by Segment (cont.)

Average gross profit from new vehicle departments declined 10.8% in the first half of 2023, as improving inventory levels reduced profitability. Used vehicle departments fared worse, declining 19.5% amid volatile prices. Fixed operations grew by 11.9%, reducing the declines from vehicle sales.

Average Gross Profit by Segment



Source: SEC Filings

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Auto Dealer Industry

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

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

Services Provided

- Valuation of auto dealer 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.

Contact a Mercer Capital professional to discuss your needs in confidence.

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