Bloomberg Intelligence BI

US Auto Dealers

2024

Franchised Dealers' Distribution, Aftersales Expertise Drive Growth

Automakers will have to lean more on retailers' sales, distribution and aftersales experience to dig out from an inventory pile-up underpinned by the highest prices in history and electrified vehicles that have attracted only a small sliver of buyers. Sales have stalled after the manufacturers' orchestrated mix shift to higher-margin vehicles in recent years generated $13 billion in new pretax profit for publicly traded dealer groups. **AutoNation, Lithia** and **Penske** split $10 billion of that total, and they're likely best positioned to benefit from the heightened dependence on the franchise base.

- **Dealers Are the Fix for Oversupply:** Dealership are equipped to facilitate sales, distribution and aftersales transactions as automakers are challenged by more urgent margin and growth concerns.
- **Retail Channel for Foreign and EV Brands:** Instant retail distribution scale for small, nascent automakers – or existing foreign brands with no US presence -- is only accessible through the already established franchised dealer network.
- **Parts and Service Are the Profit Cornerstones**: As margins contract, dealers will focus on the fixed operations of auto-part sales and service-bay revenue – the highest gross-profit-contributing segment.

June 5, 2024

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Section 1. Executive Summary

3 Million
New vehicle inventory in US, highest since December 2019

1,285,000
Average unit sales per month since January 2023

$47,278
Average price of new vehicle in US in 2024

Dealer Profit Cycles as Automakers Give Up on Retailing

The US dealer base is looking for its next growth driver as the rising cost of new vehicles forces buyers upmarket to unsustainably expensive price points. New vehicles' higher revenue contributions and wider margins are eliminating affordability for consumers, causing unit volume to shrink. That's making automakers more dependent on retail partners to efficiently sell, deliver and service their output and clear channels to maintain profitable production plans.

Dealers are navigating a return to historical industry dynamics, with the inverse gross-margin profile since 2020 – new vehicles topping pre-owned units – set to correct back to the norm, where used vehicles averaged a 220-bp advantage from 2009-19. A more disciplined approach to new-vehicle production and the recognition that factories depend on the existing franchised retail channel should keep dealership operating profit per rooftop above that of the oversupplied pre-pandemic period but well off the 2022 peak. The retail base will likely try to bridge the profit slowdown with a heightened focus on fixed operations – parts counters and service bays – until the next catalyst emerges in the form of import or EV brands seeking distribution.

Key Research Topics

- **US Distribution Requires Dealers:** There are 31,000 dealerships in the US in 2024, distributing 95% of the 16 million vehicles. Pure-play EV builders and foreign brands can only achieve distribution scale by tapping the 100-year-old retail channel.
- **Consumers Find Affordability Fleeting:** The average transaction price of a new vehicle may eclipse $48,000 in 2024, intensifying automakers' dependence on an experienced retail channel to sell, distribute and provide warranty, service and aftersales support for consumers.
- **Parts and Service Are Where the Profit Is:** Parts counters and service bays, the unsung cornerstones of dealer profitability, will rotate into a larger gross-profit role in 2024 as a margin stabilizer. Parts & Service accounts for 27% of publicly traded dealer revenue but 42% of gross profit (53% margin in 2023).
- **New Vehicle Margins Compressing**: New-vehicle buyers in the US averaged a 2.8% discount, or $1,381, off sticker prices (MSRP) to begin 2024, with 2.8 million unsold retail units.
- **Pre-Owned Market Stays Undersupplied:** The relatively low volume of new-vehicle sales and abandonment of leasing from 2020-23 will keep the used-vehicle segment understocked through 2026, creating little impetus for a retreat in consumer prices.

Section 2. Catalysts to Watch

US Dealers Eye New Brands, Fixed Ops the Bridge to Profit

The next growth catalysts for retail auto dealers will likely risk margin compression by requiring an infusion of EV pure plays, foreign brands or industries such as powersports, motorcycles or commercial trucks that need immediate and experienced distribution scale. This would hitch US dealerships' earnings growth to partnerships with unprofitable – and franchise-averse -- automakers that are trying to expand retail volume in the low-margin new-vehicle segment, while the $20 billion parts and service business and its 55% gross margin shoulders more of the profit burden.

Automakers Overshoot Supply Targets

- **2H24:** Automakers slow production to keep new-vehicle supply in check.
- **Full-Year 2024:** Slowing sales cause new-vehicle supply to average more than 3 million in 2024.
- **Full-Year 2025:** Dealership profitability returns to 2019 level at $2 million a store.
- **Full-Year 2026:** Survivors and new entrants in the US electric-vehicle market adopt franchised dealer model.

Section 3. Electric Vehicles

Auto Dealers Cruise for Growth Driver But Wary of EVs

US auto dealers need a new growth driver and appear willing to make room on their lots for pure plays that might seek a symbiotic relationship, but EVs' 100-bp gross margin disadvantage vs. the already slim 2.5% industry average is a turnoff. Applying the efficiencies and scale that drove AutoNation to a segment-leading $7 million-per-store gross profit from parts and service could improve the economics of EV maintenance.

3.1 Pluggable Profits Lack Heft to Draw Franchised Dealers

Pretax profit for publicly traded dealers has retreated due to manufacturer overproduction and a price surge of 40%, or $13,500 per vehicle, since the 2016 peak. Average transaction prices in March fell below $47,000 for the first time since October 2022, pushed under by $1,454 in retail discounts. Inventory on the verge of topping 3 million vehicles for the first time since December 2019 sapped $1.1 million in pretax profit per rooftop in 2023, compared with the 2022 peak of $5 million.

Battery electric vehicles haven't helped. Median gross margin for BEVs through franchised dealers is 1.5%, or $866 per unit, in 2024, down from 4% or $1,849 in 1Q23. The average transaction price has gone up 10%, yet gross margin has compressed as the number of nameplates sold through dealers has expanded to 78 from 67. That profit contribution, as highlighted in Figure 1, is too small to motivate the existing base to pay a premium for franchises of pure-play EV brands.

The financial benefit of representing a plug-in or battery-only model spun out of a legacy automaker would be the potential profit subsidy from fixed operations and aftersales support – a lucrative business for dealers but a bane for pure plays' balance sheets given their lack of scale and added logistical costs.

Direct sales are a margin buster for automakers. Tesla, Rivian and Lucid paid $2.8 billion to build vehicles that went unsold last year in their direct-sales models. Tesla delivered 98% of production in 2023, with the 37,000 assemblies that landed on its balance sheet representing $36,000 per unit, or $1.7 billion, in cost of goods sold, as seen in Figure 2. In 1Q24, Tesla's production throughput fell to 89%, adding 46,000 units to its inventory tally. If all of 2023's units wholesaled to franchised dealers, the automaker's gross margin would have risen 171 bps for the year.

Rivian was also short of its bill of goods in 2023, racking up $125,773 in COGS per unit and booking only $88,484 per vehicle in revenue. Lucid paid $252,775 in COGS for each of its 2023 assemblies yet only generated revenue of $88,180 while delivering just 71% of them. Selling all the output to a distribution base would have boosted gross margin by 91 percentage points.

EVs' gross margin trails the auto industry average.

Figure 1: Dealer Gross Profit by Green Vehicle Segment

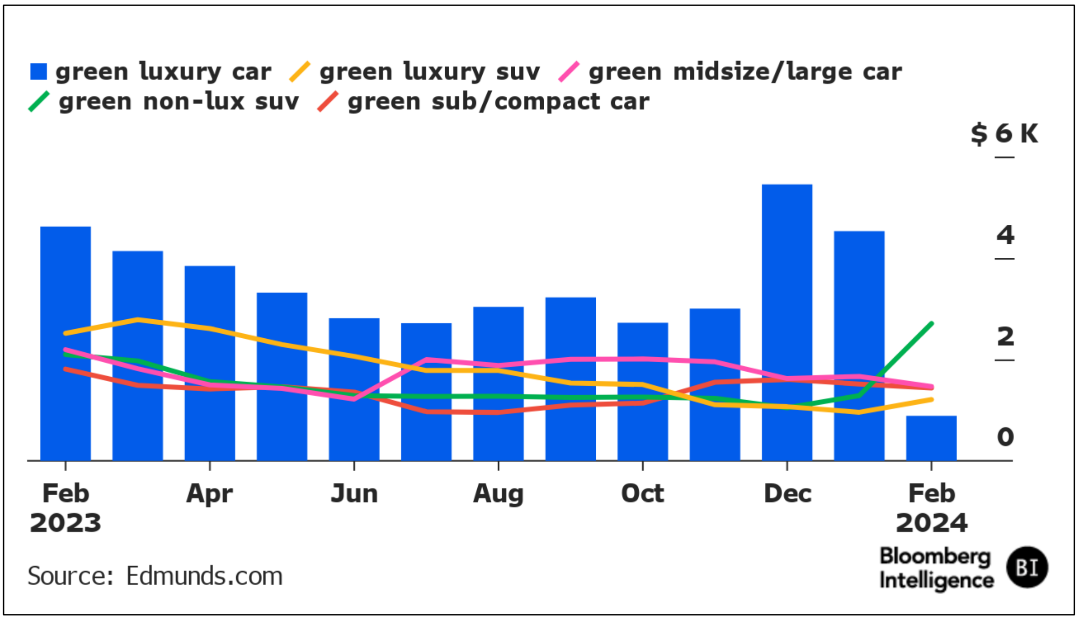
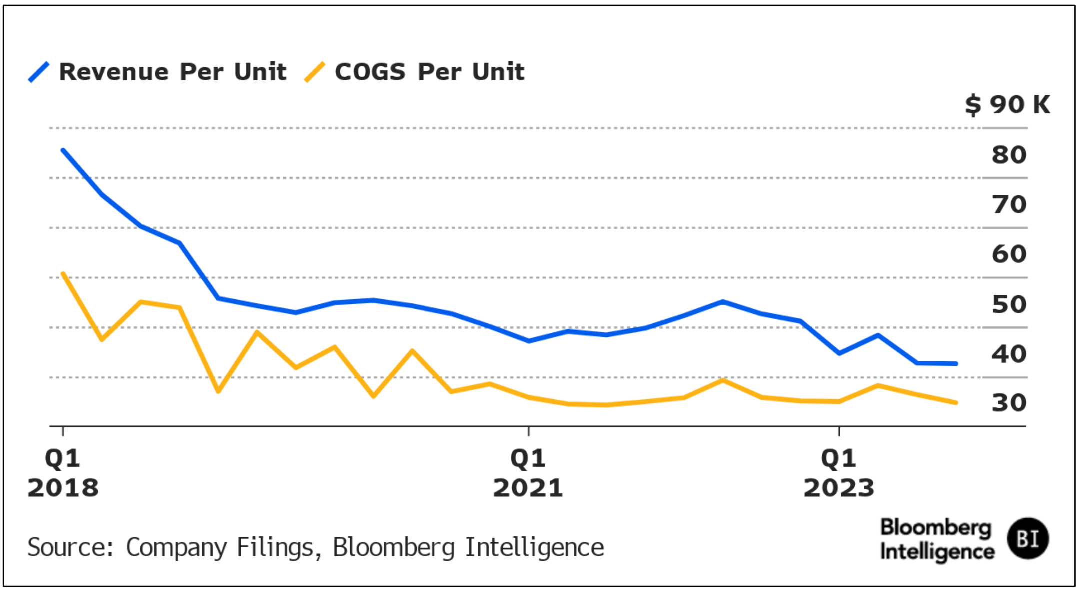


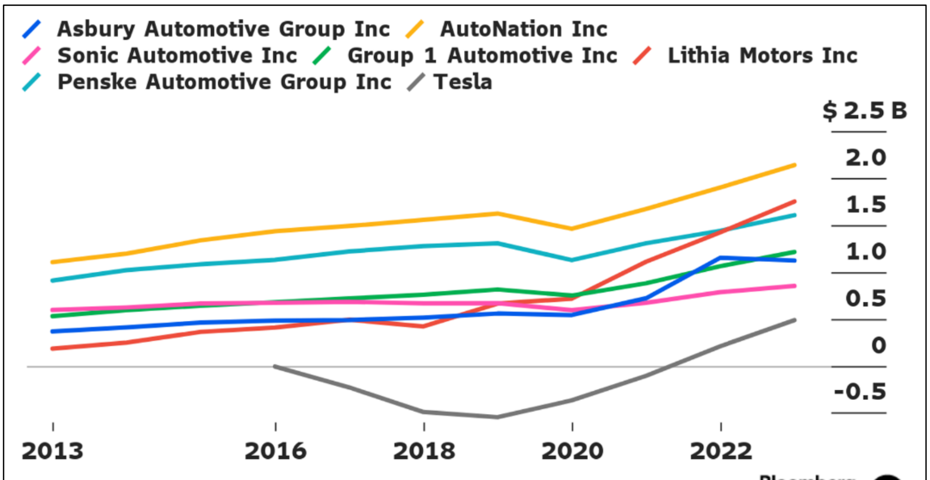
Figure 2: Tesla COGS, Revenue Per Unit Converge



The US dealer network could immediately change the calculus. The peer group posted $8.7 billion in gross profit across 1,483 stores in 2023, or about $5.9 million apiece. By comparison, Tesla's 192 service centers in the US averaged $2.5 million of gross profit, or 58% less. Rivian and Lucid don't disclose their service revenue or gross profit (which is unlikely to have turned positive yet given the high cost and small fleet of registered vehicles).

Franchised dealers would relieve manufacturers of the SG&A expense associated with building and maintaining a vehicle distribution network. Parts and service is another cost, but those units averaged 55% profit margins for the peer group and more than offset the burden. Parts and service generated $9 billion in dealer gross profit in 2023, led by AutoNation's $2.1 billion, for an industry-leading $7.9 million per store. Four of the other five producers more than $1 billion in fixed-ops gross profit, with only Sonic Automotive falling short at $868 million.

Figure 3: Service Gross Profit of Retailers and Tesla

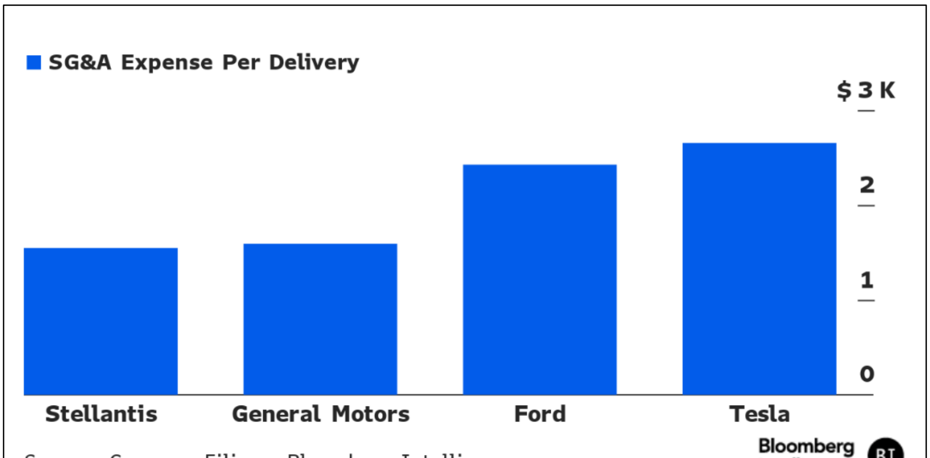


Source: Company Filings, Bloomberg Intelligence

for related operating costs, as shown in Figure 3. Since 2015, Tesla's Service & Other accumulated a gross loss of $1 billion, with a profit in 2022-23 at 6% margin. Without dealers to provide selling, service and aftersales support, Tesla's $2,651 in 2023 SG&A per delivery was the highest of the US automakers, 72% above Stellantis. A key cost comes from having to dispatch crews to customers' locations rather than having accessible service facilities.

BI **Tesla's cost per delivery is highest among US automakers.**

Figure 4: SG&A Expense Per Vehicle Delivery in 2023



Source: Company Filings, Bloomberg Intelligence

Section 4. The Consumer

Maligned Auto Dealers Saved Buyers $219 Billion

Because of the low margins, the threat to AutoNation, Penske, CarMax and other retailers that automakers will adopt the direct-sales model used by Tesla and other pure-play EV makers is overblown. A similar no-haggle model also would eliminate the price flexibility that saved buyers $219 billion, or $2,357 per vehicle, over four years, and have manufacturers take over the least profitable part of the auto retail business.

4.1 New-Vehicle Sales Are Dealers' Least Profitable Business

US auto supply has swung quickly to frothy from scarce, intensifying automakers' reliance on dealers to clear about $150 billion in inventory in a market that generates $62 billion in retail sales a month. To keep the retail channel flowing, automakers will raise incentives and assistance to dealers to offset carrying costs.

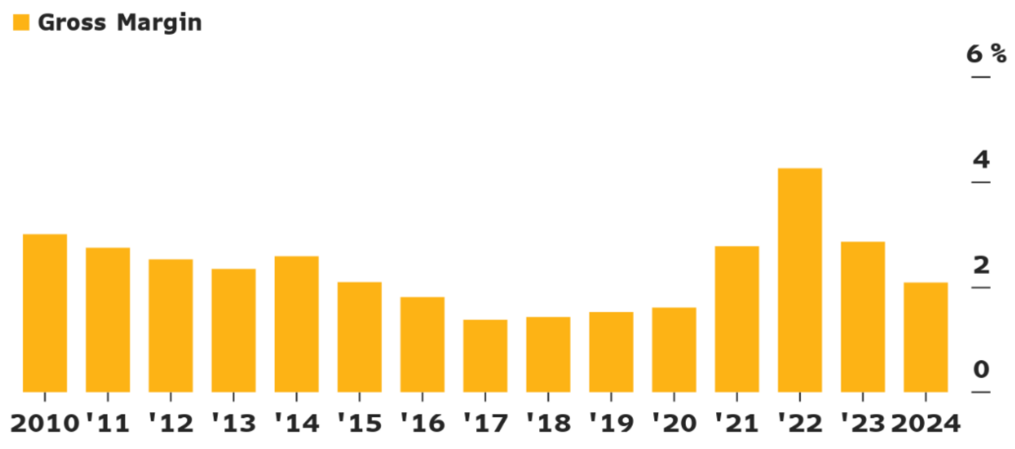
Franchised dealers accounted for 95% of new-vehicle deliveries in 2023, with Lithia – the largest dealer group by revenue last year – by revenue last year – Asbury and AutoNation each generating more than 900 new-vehicle unit sales per rooftop. New-vehicle sales are dealers' lowest-margin segment, subsidized by used-vehicle sales, parts, service and financial-services operations. Median retail gross margin for the entire US new vehicle fleet is 2.1% -- or $871 – per unit in 2024.

Record-high new-vehicle prices have heightened misguided talk of direct sales. Only 21% of nameplates transacted below $30,000 last year, vs. 49% in 2016; less than 1% were below $20,000 vs. 6%. Yet retailers' 2.5% new-vehicle gross margin since 2010 – highlighted in Figure 5 – is slim, and manufacturers wouldn't be able to replicate even that narrow profit contribution.

Notions that a direct-sales model would cut out the "middleman" and save consumers thousands of dollars ignore the added costs automakers would take on to reinvent the wheel and learn how to be retailers. Months of wait times are likely, and warranty, repair and other aftersales services could be upended.

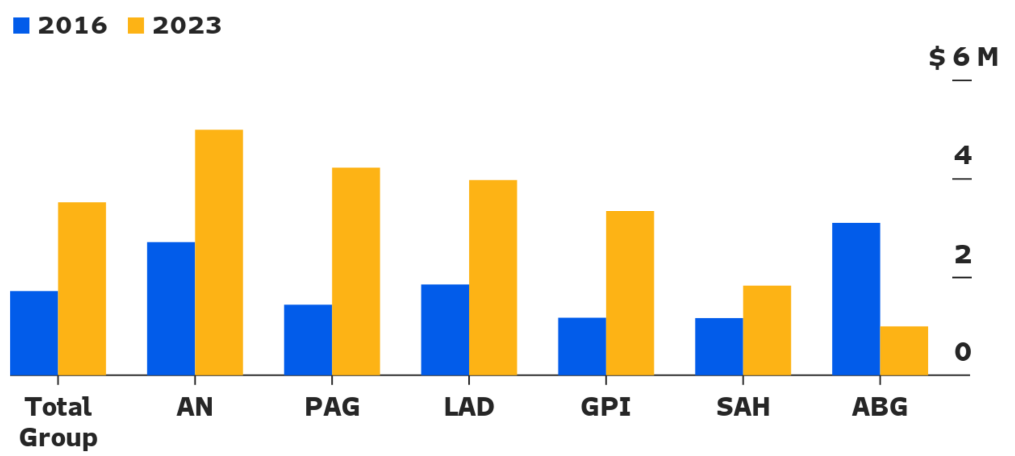
Parts and service help subsidize new-vehicle sales.

Figure 5: Dealership Retail Gross Margin (%)



Source: Edmunds.com, Bloomberg Intelligence

Figure 6: Dealers' Pretax Profit Per Store 2016 vs. 2019



Source: Company Filings, Bloomberg Intelligence

higher-priced, wider-margin vehicles. Manufacturers' orchestrated shift to push buyers into light trucks began in earnest in 2013 and led to a lack of available vehicles in entry and move-up segments. Ford's, GM's and Stellantis' US brands have eliminated 10 car nameplates – identified in Figure 7 – that accounted for 841,925 unit sales in 2016.

The move upmarket enabled GM to increase pretax profit by 7% despite a 19% decline in unit volume in the four pandemic-disrupted years of 2020-23 compared with 2016-19. GM generated 99.2% of adjusted Ebit in North America in 2023, up from 90% in 2022.

Ford and Stellantis followed the same strategy, each retailing 2 million fewer units through their US franchise networks in 2020-23 relative to 2016-19. Without the unprofitable units dragging on earnings, the three US-based automakers increased their average transaction price to more than $51,000 in 2023 from less than $40,000 in 2016. This meant an additional $46 billion in pretax profit for them and $13 billion more for dealers – led by a $3.9 billion gain for Lithia and $3.3 billion at Penske.

Dealers averaged 1.5% gross margin in 2016-19; 2022 was their best year at 4.3%, an unprecedented period of consumers paying over manufacturers' suggested retail prices (1.2% over MSRP) in an undersupplied market. The peer group of franchised dealerships split a retail revenue pool of $5.4 billion in 2023. Despite selling 2 million fewer units than in the peak US volume year of 2016, pretax profit per store jumped 132%.

Penske's average gain of $2.7 million led the group, while AutoNation stores were the highest earners, averaging $5 million each. Retail discounts of 1.2% in 2023 translated into a $9 billion cost savings for consumers compared with the MSRP they'd likely pay under a direct-sales model.

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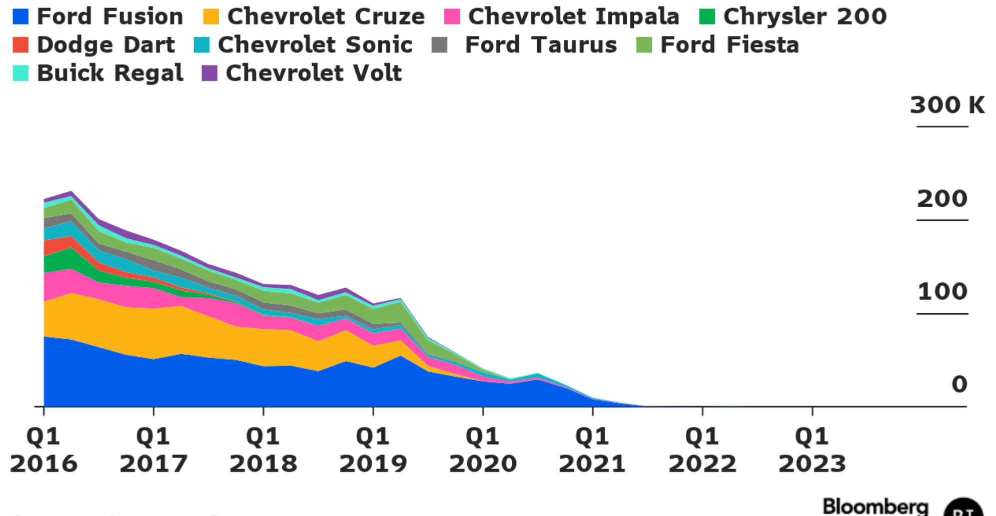
US automakers' push for higher prices has reduced affordability – and demand.

Figure 7: Volume of Affordable Models Discontinued



Source: Company Data

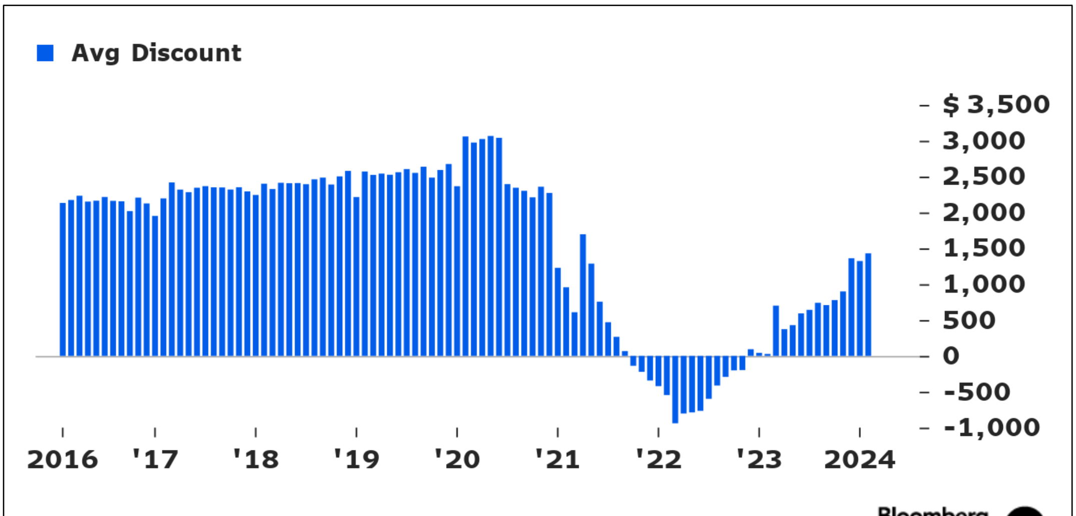
As more technology and electronic content is added to vehicles, including EVs, the dealership model has become increasingly important for manufacturers' sales, service and aftersales support. Though new-vehicle unit volume for publicly traded dealers is down 5% from the 2016 peak, the 37% boost in average transaction price to $48,000 has expanded the retail revenue pool by $140 billion.

It also has dented affordability, and the drop in new-vehicle volume to 15.5 million in 2023 – with optimistic forecasts of 16 million in 2024 – from a peak of 17.5 million hints at demand challenges. However, a recent ramp-up in new-vehicle output by automakers has tipped the supply-demand balance back in consumers' favor.

The discount off MSRP – a price break consumers wouldn't get if buying directly from manufacturers – is 2.9%, or $1,430, per vehicle in 2024, increasing sequentially every month since January 2023. At the current pace, new owners will save more than $20 billion this year, relative to a no-haggle, fixed-price sales model.

By comparison, with new-vehicle inventory below 1 million units, transaction prices stayed above MSRP in the US for 14 consecutive months from October 2021 through November 2022. Consumers averaged $477 over sticker price for the period, peaking at $904 in March 2022.

Figure 8: Consumers' Average Discount Per Vehicle in US



Source: Edmunds.com, Bloomberg Intelligence

Section 5. M&A Outlook

Cull of 68% of US-Brand Dealers Needed to Match Toyota

With sales stalling and margins narrowing, the industry may appear ripe for consolidation. The pool of US auto dealers selling domestic brands would need to shrink 68% -- or more than 8,000 locations – to get in line with Toyota's per-store sales of 1,500 new-vehicle units, supporting profit amid historically low volume. Toyota's stores are the volume-brand valuation-multiple leaders in M&A, averaging more than $3.1 million each in new-vehicle gross profit last year. The top US brand was GM's Cadillac at $489,000.

5.1 M&A May Pause as High-Earning Stores Getting Pricey

Sales and purchases of franchised dealerships may slow in 2024 as the retreat in profitability and cash generation from the 2021-22 apex pushes sellers to the sidelines. Publicly traded dealers, which spent $16.3 billion on M&A since 2020, may get more selective as the new-vehicle gross profit density of import-brand stores makes their valuations expensive. Dealers seeking to divest underperforming domestic-brand stores will have to accept low multiples to entice buyers.

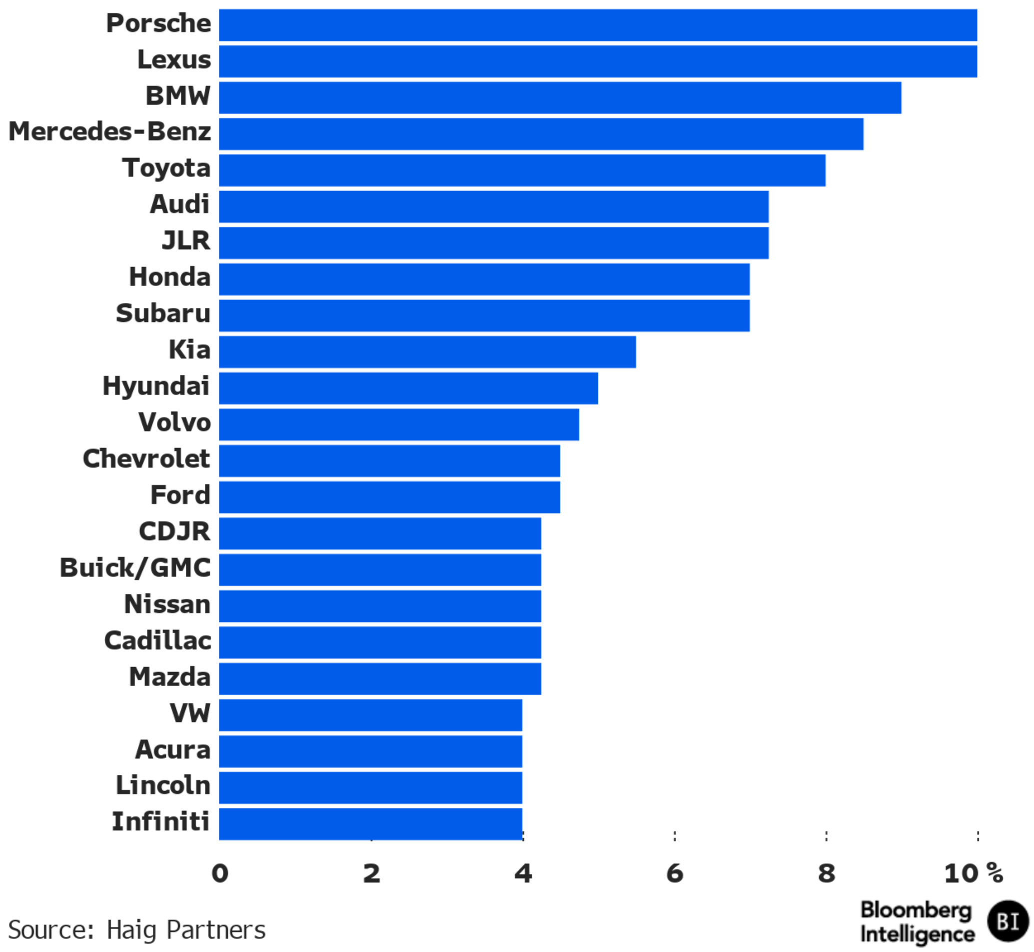
M&A valuations based on cash flow or Ebitda don't make sense for auto dealers. The industry typically turns to third parties such as Haig Partners, which calculates and publishes Blue Sky valuation multiples – listed in Figure 9 – based on pretax earnings and other factors specific to brands and locations.

The unprecedented burst of M&A that began in 2020 was funded by record profitability and cash generation in a margin environment that favored retailers. The $16.3 billion in cash paid for acquisitions in the four years through 2023 was 31% more than in all of 2006-19.

Cash generation from operations compressed 75% last year to $1.8 billion for the peer group, from a peak of $7.5 billion in 2021 – the year with the highest dollar value of acquisitions, with Lithia accounting for 40% -- as a rebound in production tripled new-vehicle inventory back to 3 million units. Pretax profit per store for the group fell 31% to $3.5 million from $5 million in 2022.

A repeat of the chronic new-vehicle oversupply that plagued the industry prior to 2020 risks further compressing the profitability of saturated brands and muting transaction volume back to the 355 average of the period. Total industry deals surged to 707 in 2021 and reached 634 in 2022 – when tight new-vehicle supply pushed dealership earnings to a record high – before slowing to 513 last year.

Figure 9: 'Blue Sky' Dealership Valuations by Brand



Source: Haig Partners

5.2 Buick Is Prime Example of Attrition Need

Dealership overpopulation puts some domestic brand stores at risk: Jeep, Lincoln, Ram, Dodge, Buick and Chrysler dealers generated less than $100,000 in new-vehicle gross profit per rooftop in 2023. As noted in Figure 10, the number of Ford, GM and Stellantis branded stores has already fallen 39% since 2007, to below 20,000 for the first time since 2011, as structurally lower volume and higher transaction prices make it difficult for small and remote locations to survive.

Of GM's 900 net closings in 2023, 896 were Buick locations, an ominous sign for the make as dealers averaged just 79 sales per rooftop. It was one of only three volume brands – Dodge and Chrysler were the others – to sell fewer than 100 units per store. Buick is down to 1,062 locations in the US from 2,751 in 2007.

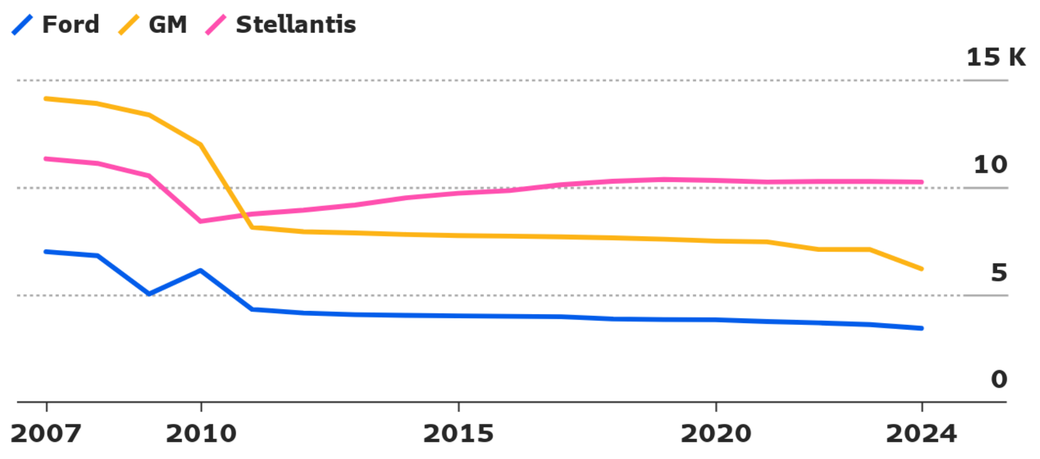
Chevrolet dealers led legacy brands with an average of 523 sales per store in 2023, 12th-best in the US. The Ford brand ranked 14th at 491 units per location. GMC was the only other domestic brand above 300.

Toyota stores top the list in Figure 11, averaging 1,542 sales a year in 2023, and $3.1 million in gross profit, edging out Porsche dealers' $2.7 million. Lexus retailers grossed $2 million; BMW and Mercedes were the only others above $1 million. Those five brands' stores had the highest valuation multiples in 2023 deals.

Toyota represents 15% of AutoNation franchises, generating 19% of the dealer group's new-vehicle revenue. AutoNation is 72% tilted to foreign brands. Toyota contributed 26% of 2023 new-vehicle sales for Penske, while domestics are less than 5% of its US franchises.

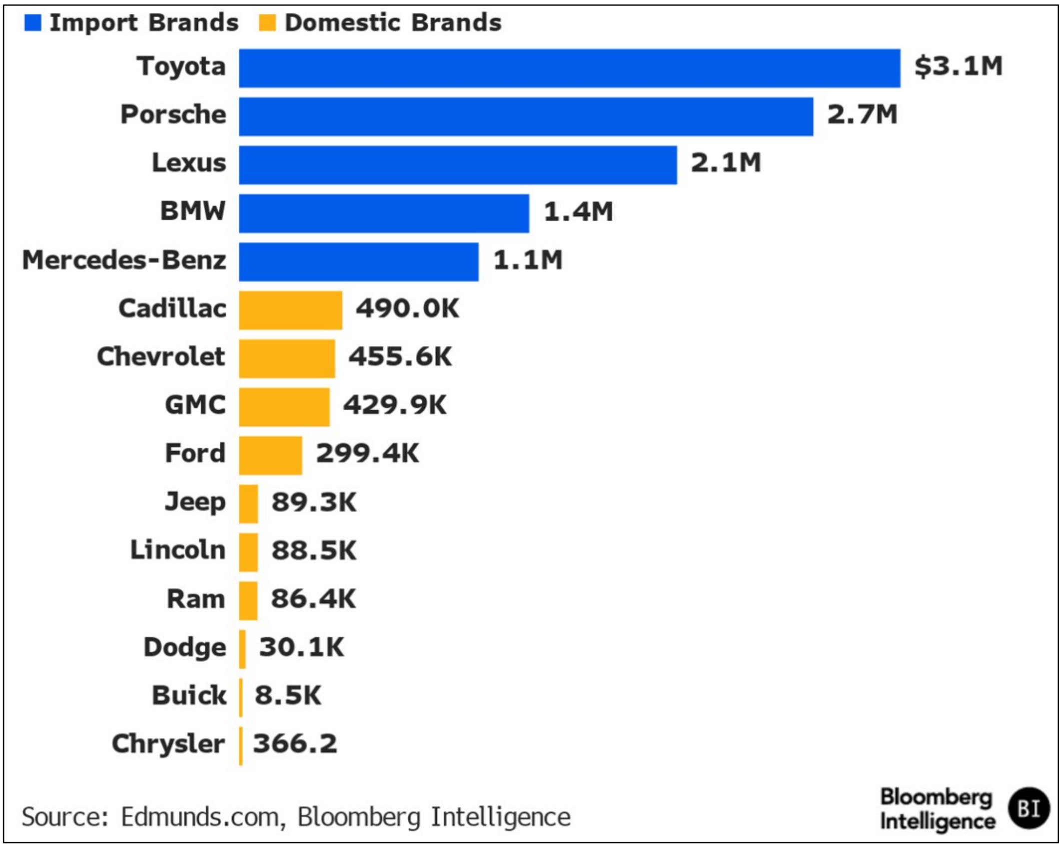
Domestic-branded auto dealerships appear most likely to close.

Figure 10: Retail Locations in US



Source: Source: Company Data, Crain Communications

Figure 11: New-Vehicle Gross Profit Per Store



Section 6. Dealer Services

Auto Dealers Have Jump on $9 Billion Service Sales Bump

Services may provide another avenue of growth for auto dealers. Rising vehicle complexity gives franchise dealers an opportunity to outgrow independent garages by 50 bps a year in service sales over the next two years, gaining 20 bps of market share worth $8.67 billion. Factory-backed retailers can leverage their proprietary diagnostics, tools and expertise learned through warranty work to expand into the two-thirds of the $387 billion market they don't control.

6.1 Turning Wrenches a $4 Billion Revenue-Growth Play

Local dealerships – backed by factory tools and processes – can win more customer-paid business as a larger portion of the US fleet ages out of warranty. An average new-vehicle warranty of five years in the US means 88% of vehicles in operation aren't covered by factory programs.

Increasing vehicle complexity – advanced safety, efficiency, connectivity, software and diagnostics – will expand the revenue base from parts counters and service bays. Franchised dealers' largest opportunity is to take market share from independent repair facilities, which are forecast to post $275 billion in revenue, or 71% of the total. Dealership auto-care revenue growth will likely outpace independents by 50 bps in 2024 and 2025, we calculate, driving a 20-bp segment share gain that represents an additional $4 billion in annual revenue for the group.

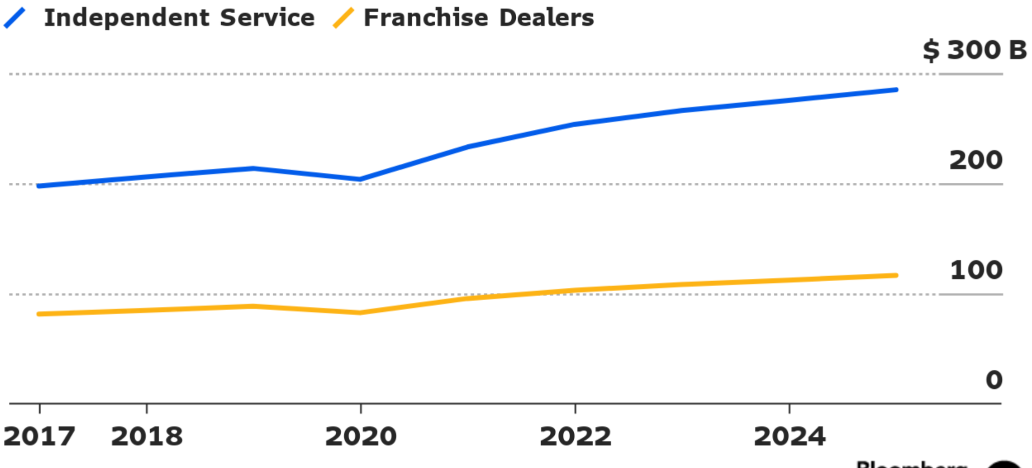
The franchised dealer base has held about 29% of the auto-care market since 2017. Vehicle miles traveled fell 11% in 2020, resulting in less wear and tear, and DIY repairs jumped, disrupting dealership service revenue in the pandemic period. The three-year compound annual revenue growth of dealers outpaced independent service providers by 30 bps in 2017-19, then declined 200 bps more in 2020.

Parts counters and service bays will rotate into a larger gross profit role for dealers as a margin stabilizer. This is needed to offset price weakness brought on by overproduction of new vehicles and contracting pre-owned margins. Parts & Service accounts for 42% of publicly traded dealer gross profit but only 27% of revenue. The peer group's Parts & Service revenue grew 12% to $9 billion in 2023, less than 10% of a $109 billion addressable market that has grown at a 4.8% five-year annual rate.

AutoNation's segment-leading store count, with 51% in the most vehicle-dense states – California, Florida and Texas – makes it the service gross profit leader at $2.1 billion in 2023, as seen in Figure 13. Penske's 59% gross margin is the widest of the peer group.

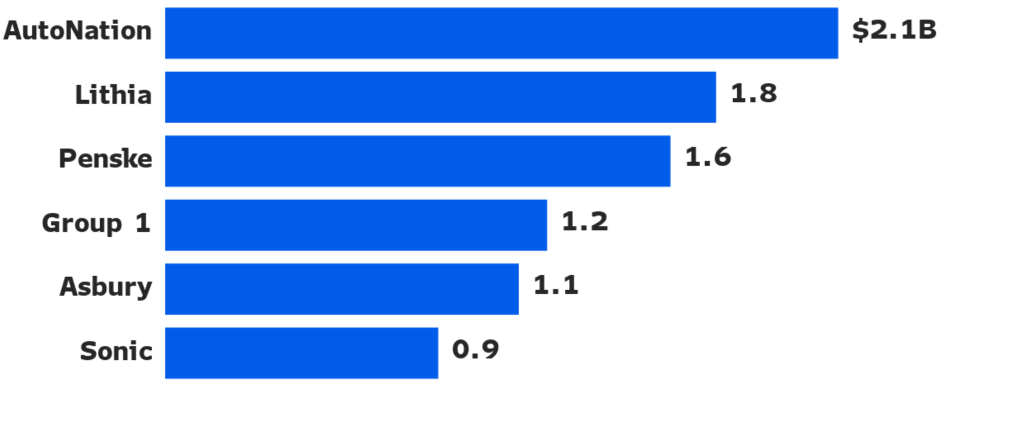
Independent repair shops control 71% of the $387 billion parts and services market.

Figure 12: US Auto-Care Spending



Source: Auto Care Association/AASA Channel Forecast Model

Figure 13: Dealers' Service Gross Profit 2023



Source: Company Filings

Section 7. BEV Markdowns

BEV Markdowns, Tesla $5,000 Off Sound Demand Alarm

Dealers considering whether to partner with new EV makers are already struggling to move Evs from legacy brands. Evs are stockpiling faster than other drivetrain types, wiping out dealers' gross margin. A tripling in battery-only EV inventory despite $2 billion in discounts and incentives could balloon costs past $8 billion for dealerships and automakers this year if 1Q is a guide.

7.1 BMW BEV Pile-Up Dents AutoNation Per-Store Profit

The tenuous demand profile of BEVs in the US is flipping inventory risk to dealers with exposure to brands that have overshot on supply. AutoNation's profit slide at its 38 Mercedes and 16 BMW stores is a harbinger. AutoNation dealerships earned $225,000 per BMW franchise in new-vehicle gross profit on combined sales of 3,486 iX and XM models in 1Q, compared with $1.1 million per rooftop on the sale of 2,760 of those models in 1Q23. BMW iX retail gross profit per unit declined to $825 in 1Q from $6,000 in the year-earlier period as the inventory of the nameplate increased 78%.

Mercedes' BEV inventory increased 38% and represented 17% of its total US units to begin April, with gross profit per BEV falling 30% to $1,819 in 1Q. BMW's aspirations propelled BEVs to 31% of its US supply after a 115% jump in unsold units on April 1.

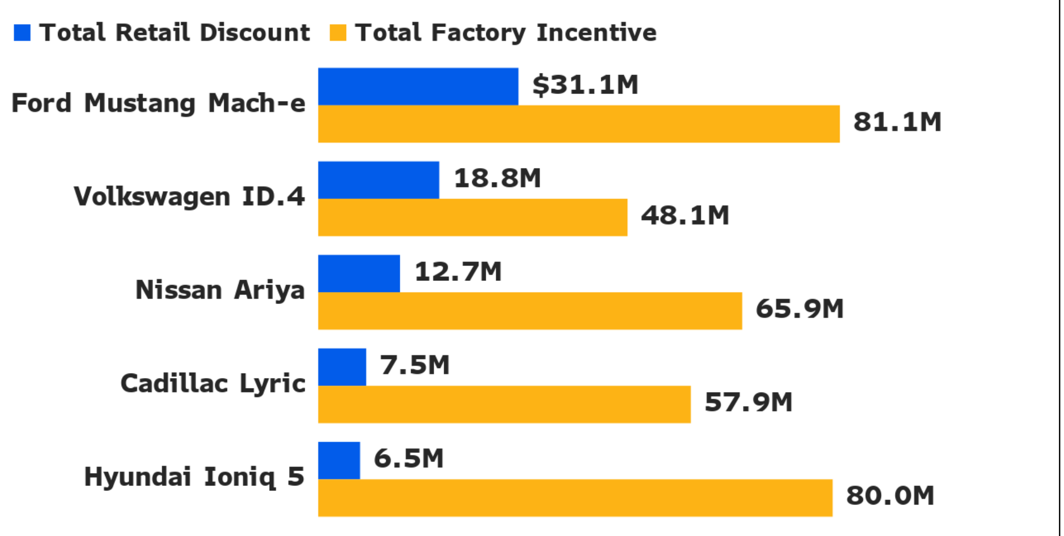
Dealer discounts totaling $313 million in 1Q – detailed in Figure 14 -- proved insufficient to boost BEV demand, prompting manufacturers to pile on factory incentives to clear the retail channel. Battery-only vehicle supply surged 202% year over year to start 2Q vs. 155% for plug-in hybrids and 103% for gasoline hybrids. Internal combustion supply rose 55%. Total US inventory was 75 days.

AutoNation stores were the most profitable in 2022, booking $7 million per location before slipping $2 million in 2023, largely due to discounting. Median gross profit on BEV, plug-in hybrid (PHEV) and hybrid drivetrain vehicle sales retreated to $719, or 1.3% of the transaction price, in March from $2,005, or 3.5%, a year earlier. Of the 75 advanced drivetrain vehicles, 21 generated zero gross profit for retailers, compared with only two of 70 a year prior.

For GM's Cadillac, Ford, Hyundai, Nissan and Volkswagen's highest revenue-generating battery-only models, factory incentive spending was 4x the dealer discount in 1Q. Ford dealers missed out on $31 million in retail revenue, or $3,200 a vehicle, by moving off sticker prices, while the factory pitched in $81 million, or $8,500, to move more Mustang Mach-Es. Tesla, the highest-volume BEV seller in the US, averaged $4,950 in incentives in 1Q, adding $834 million in cost of goods.

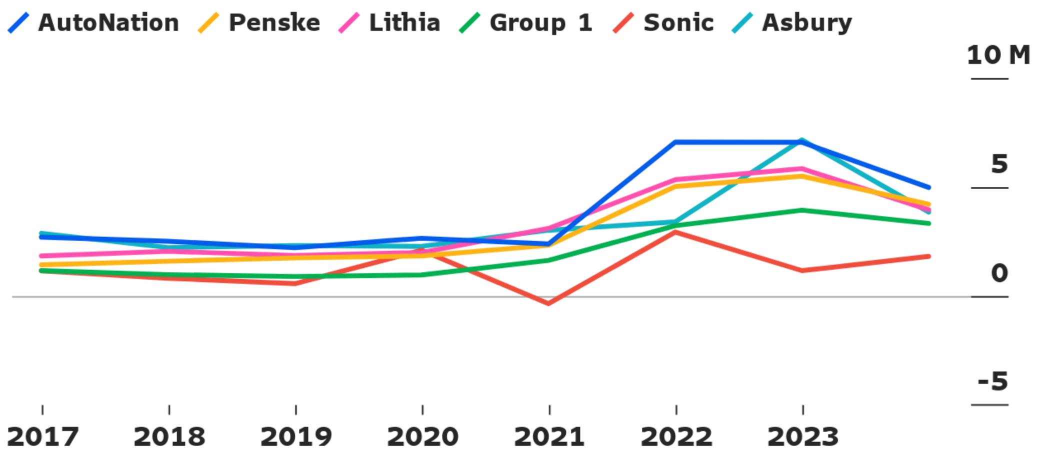
Ford dealers' combined supply of F-150 Lightning and Mustang Mach-E soared to 130 days to begin 2Q vs. 31 a year earlier. Both are selling for more than $3,500 under sticker before factory incentives. Lightning was $150 over in March 2023. Hyundai-Kia stores' averaged 108 days of inventory of Ioniq 5, Ioniq 6, EV6 and EV9 vs. 60 days for the company's total US portfolio. Tesla's global inventory ended 1Q at 158,000 units, 71% higher than a year earlier.

Figure 14: BEV Retail Discounts, Factory Incentives in 1Q



Source: Company Data, Edmunds.com, Motor Intelligence, Bloomberg Intelligence

Figure 15: Pretax Profit Per Location for Public Dealers



Source: Company Filings, Bloomberg Intelligence

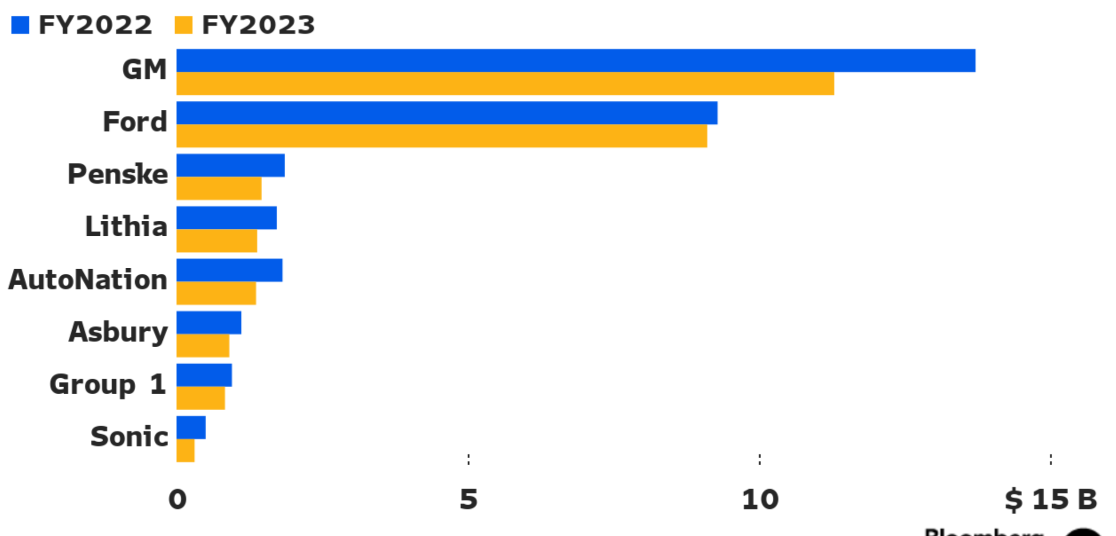
The BEV with the highest retail gross margin in April was Porsche Taycan at $8,163 -- though retailers watched more than $3,500 of gross profit disappear in the past 12 months. Ford dealers didn't generate any gross profit from the Mustang Mach-E and F-150 Lightning for the month, justifying production cuts until inventory becomes more manageable.

Lithia gets 45% of revenue from Asia-based automotive brands, which may help the dealer group avoid the most intense price pressure in 2024 as inventory bloats. AutoNation garners 30% and Penske 41% of new-vehicle revenue from premium German brands Audi, BMW and Mercedes, whose commitment to BEVs in the slow-to-adopt US market is driving up inventory. The three makes began 2Q carrying 136 days of BEV supply, up from 88 a year earlier, topped by Audi's 73 days. Stellantis has 95 days of supply, Ford has 80 days and GM is at 61.

Dealers and manufacturers consider 60 days' supply -- or a 2-to-1 inventory to sales ratio -- to be manageable before retailers are forced to discount and factories subsidize demand with margin-compressing incentives.

Yet a 74% increase in supply has only nudged prices 1.5% lower than 2023's record high -- increasing manufacturers' dependence on franchised retail partners to move units and keep the channel open or risk margin-damaging production cuts. As noted in Figure 17, adjusted pretax income for the peer group fell 17% compared with 11% at Ford and GM combined.

Figure 16: Adjusted Pretax Income



Source: Company Filings, Bloomberg Intelligence

Section 8. Used-Autos Outlook

Used Auto Price Puff Lasts on Supply Like New-Car Nadir

A drop in off-lease autos entering the used-vehicle pool means a market that historically subsidized full-line dealers' low-margin new-auto sales has lost its profit punch, and inventory acquisition costs will stay near record highs near term. Segment gross margin shrank an average of 350 bps below new vehicles in 2021-23, turning away full-line dealers, while pure-plays CarMax and Carvana are forced to overpay for inventory.

8.1 Thin Off-Lease Supply Until 2026 Puts Floor Under Prices

US lease returns are set to drop 17% in 2024 and bottom at 2.4 million vehicles in 2025, after totaling 5 million or more every year from 2018-22. The tight supply-demand balance in 2020-22 muted new-vehicle volume while eliminating the need for incentives such as leasing. The dynamic will leave dealers overpaying for pre-owned wholesale inventory -- either at auction or consumer trade-in. Used prices peaked at $32,974 in 2Q22.

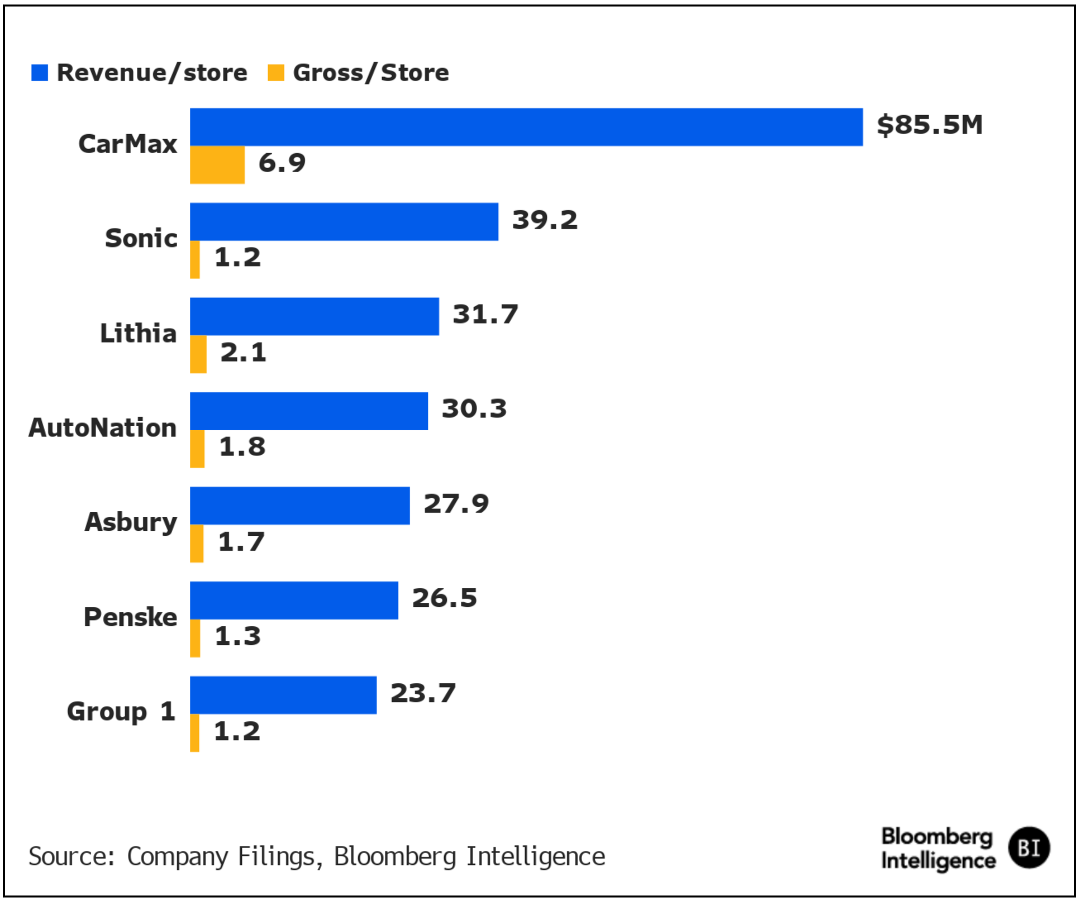
Scale still outweighs tight supply as a profit driver in used vehicles, as private sales -- more than 90% of pre-owned transactions -- influence margin dynamics for dealers. CarMax has the scale to dominate the segment, more than doubling full-line dealer Sonic Automotive's $39 million in revenue per store and tripling Lithia's $2 million in gross profit per rooftop. CarMax and Carvana in 2023 accounted for a record 48% of retail and wholesale pre-owned vehicle volume and 52% of total pre-owned gross profit.

Full-line dealers earn only 14% of gross profit from used vehicles, compared with 25% from new and 41% at the parts counter and service bays. This diversity enables franchises to alter their earnings strategy as market conditions and segment dynamics dictate, evident in the downshift to used comprising 48.5% of revenue for the peer group in 2023 vs. 54.2% in 2022. Pre-owned autos' gross profit peaked at 31.6% in 2020 -- when new vehicle production ceased for a period during the pandemic.

Lithia sold 425,000 pre-owned units in 2023, the most among full-line dealers, generating $721 million in used-vehicle gross profit at 6.6% margin, also leading the peer group.

Fewer lease returns are shrinking used-vehicle supply, pushing up prices.

Figure 17: Used Vehicle Revenue, Gross Profit Per Store



8.2 CarMax, Carvana Marred by Used-Auto Profile

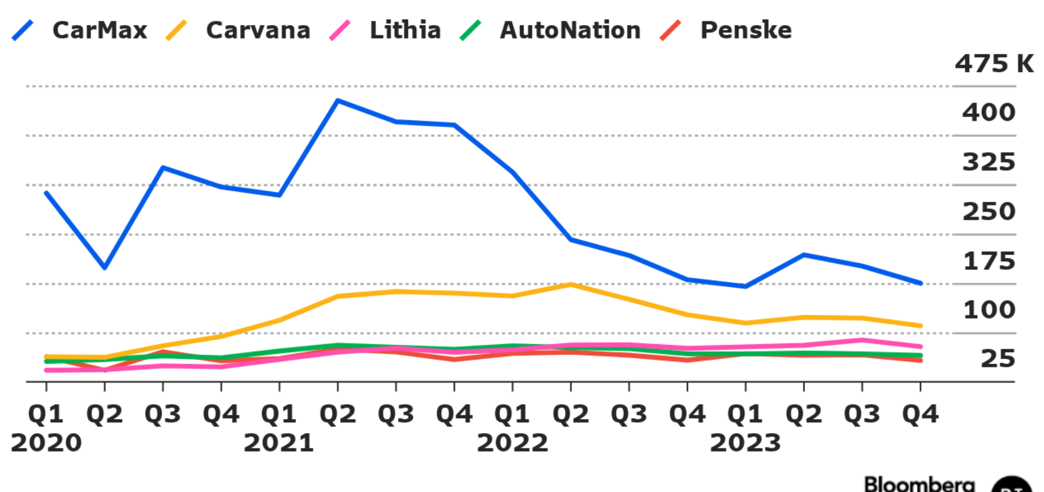
Deteriorating profit conditions are more detrimental for pure-play pre-owned vehicle dealer groups CarMax and Carvana than for AutoNation, Lithia and Penske, which have backed off used-vehicle acquisitions to divert attention to higher-margin parts and service businesses. CarMax's adjusted pretax profit per location declined in nine of the previous 10 years -- the exception being supply-constrained 2022, when the metric jumped 48% to $6.4 million. CarMax's pretax income in fiscal 2024 ended February was $2.6 million per rooftop, a 60% decline from the 2015 peak.

Quarterly used-vehicle unit sales at the three largest full-line dealers have declined a combined 12% since the 2Q22 volume peak of 228,000. Together, CarMax and Carvana unit sales have fallen 51% in the same period, as seen in Figure 19.

The retreat in new-vehicle retail gross margin is motivating the peer group to shift attention to more profitable businesses, turning away from OEM partners just as they're navigating a period of soft demand. In the supply-constrained pandemic period, monthly auto sales exceeded total inventory in nine of 10 months and by a total of 800,000 units from July 2021 through April 2022, sending the segment's gross margin to a record 13%. Since then, new vehicles have lost 460 bps of gross margin and are the narrowest since 1Q21.

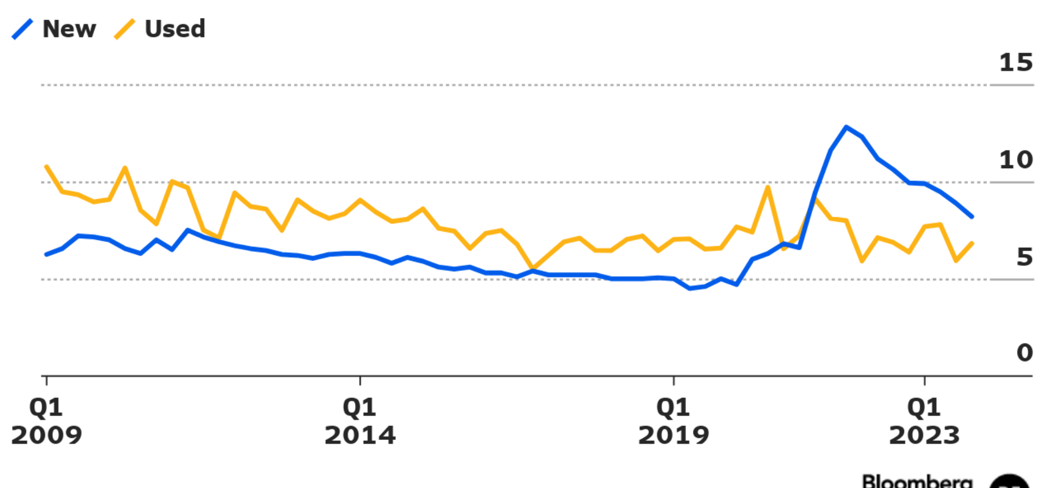
Used-vehicle gross margin, which peaked above 9% in 2Q21, has been less volatile, as shown in Figure 20, sliding only 230 bps, with additional upside potential as elevated new-vehicle prices push consumers to depreciated pre-owned markets.

Figure 18: Retail Used Vehicle Volume by Dealer Group



Source: Company Filings, Bloomberg Intelligence

Figure 19: New and Used Vehicle Gross Margin Trend



Source: Company Filings, Bloomberg Intelligence

Section 9. Interest-Rate Pressure

Auto Dealers' Walloping by Interest-Rate Swing Looms

Auto dealers are on track for a $675 million profit hit as rising interest rates make inventory more expensive to keep, with sweeteners from manufacturers only taking the edge off. Rising new-vehicle output despite inventory at a four-year high is pushing carrying costs above the cash that automakers provide to help dealers move inventory -- $172 per unit in 2023.

9.1 Interest Rates a $675 Million Profit Swing for Dealers

Higher interest rates are overtaking factory assistance for US auto dealers and causing a swing to a $352 million profit hit from a $323 million earnings benefit in 2022, when inventory turns peaked at 11x the monthly starting supply. Turns are set to drop below 6x this year. The expected 16 million new-vehicle sales represent only a 3.2% volume gain, while monthly average starting inventory of 3 million units is a 46% jump in supply. In addition, US auto output rose 4.7% in 1Q.

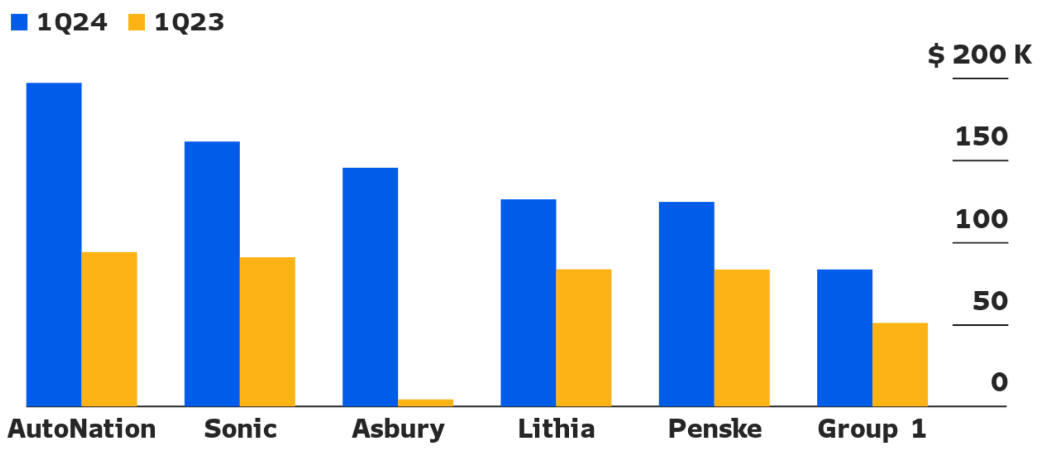
Floor plan (financing) expenses paid to automakers by retailers and manufacturer assistance to the franchised dealer base underpin the movement of output from the factory to consumers. With near-zero interest rates and historically short inventory turns during the pandemic, the per-unit payment from the factory per dealer sale topped carrying costs. Floor plan assistance hadn't fallen short of interest expense since 2019, when new-vehicle inventory turns were only 4.4x. Following the 2022 peak, turns fell to 7.6x in 2023 as Lithia and AutoNation each saw floor plan interest expense rise more than $100 million.

Interest expense for the publicly traded dealer peer group totaled $548 million last year. The six companies reported total floor-plan interest expense of $216 million in 1Q, double the year-earlier quarter, though manufacturers' assistance softened the earnings hit to $88 million. AutoNation cited $46.8 million in floor-plan interest expense, or $196,813 per store, compared with $93,846 a year earlier. The federal funds rate spiked to 4.1% in 2022 and 5.4% by year-end 2023. It was 1.55% in 2019 and fell below 1% in 2020 and 2021.

The peer group's vehicle-financing expense increased $347 million in 2023, eclipsing the combined expense in 2021-22. Lithia's 269% year-over-year surge cut pretax profit by $104 million before factory assistance. The group received $549 million in factory financial aid in 2023, but the per-vehicle payout couldn't offset the higher carrying costs of rising interest rates, flipping from a $236 million benefit in 2022 to a $9 million drag.

For the six peers, floor plan assistance cut new-vehicle cost of goods by an average of $464 per unit in 2023, a benefit that's expected to deteriorate in light of interest rates in 2024.

Figure 20: Floor Plan Interest Expense Per Location



Source: Company Filings

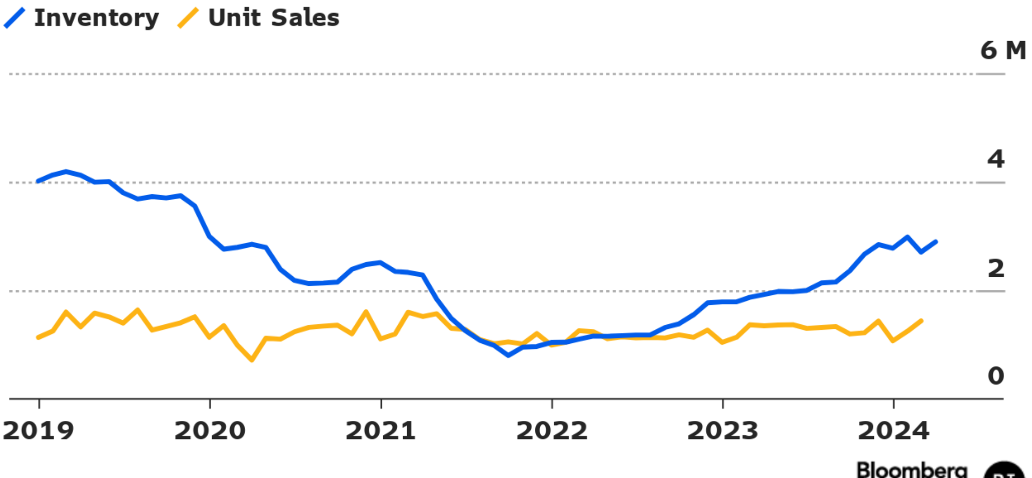
9.2 Inventory at 2.5x Sales Make Overstocks Unavoidable

Inventory is stockpiling at US dealers as automakers' production ramp-up ignores demand dynamics in favor of covering fixed costs. As Figure 22 shows, US new-vehicle unit sales have remained at 1-1.5 million a month, with a median of 1.3 million, since 2009. Inventory has been more volatile, with a median of 3.3 million units -- a 2.5x multiple of sales -- and a range that topped 4.3 million in 2Q04 and contracted to 800,000 in 4Q21. Supply in 2Q of 3 million units is the highest since December 2019, while unit sales haven't topped 1.5 million since June 2021.

Building Asia-brand inventory would avoid sacrificing more margin. US auto dealers with new-vehicle revenue mix tilted toward Asia-based brands -- Lithia (57% of volume), AutoNation (45%) and Group 1 (44%) -- will have the firmest prices and margins in 2024. Their manufacturing partners raised North America production by 8% year over year in 1Q, yet still have a manageable 58-day supply.

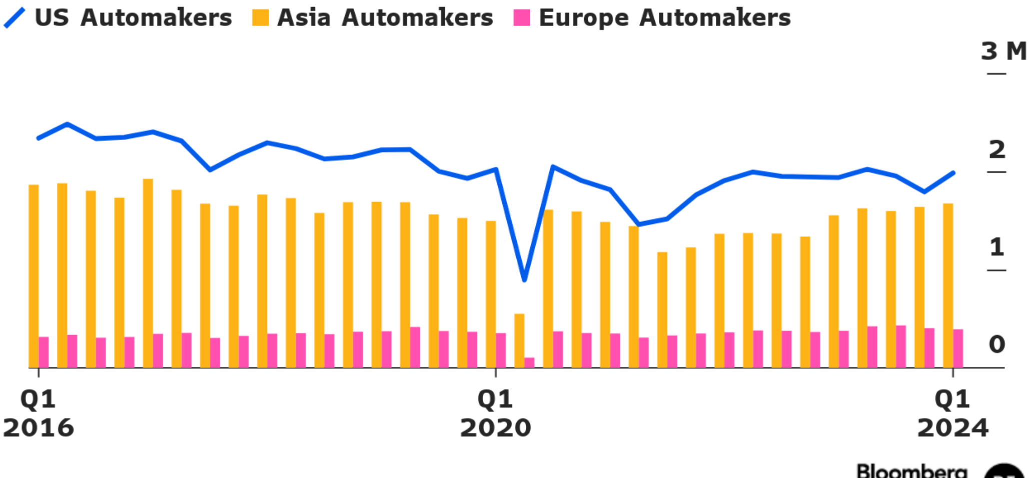
Though the average industry price fell 3% in 1Q, the 11% jump in unit sales drove a 7% expansion in the retail revenue pool to $66 billion. Dealers of European brands are saddled with 89 days of supply after inventory growth outpaced production by 4% year over year in 1Q. Retailers of US makes had 76 days to begin 2Q, even after a downshift in 1Q output to 2.4% growth, as additional inventory gains change the profit dynamics.

Figure 21: Piling Inventory on Dealers Hasn't Driven Volume



Source: Company Data, Crain communications, LotLinx

Figure 22: North America Quarterly Production

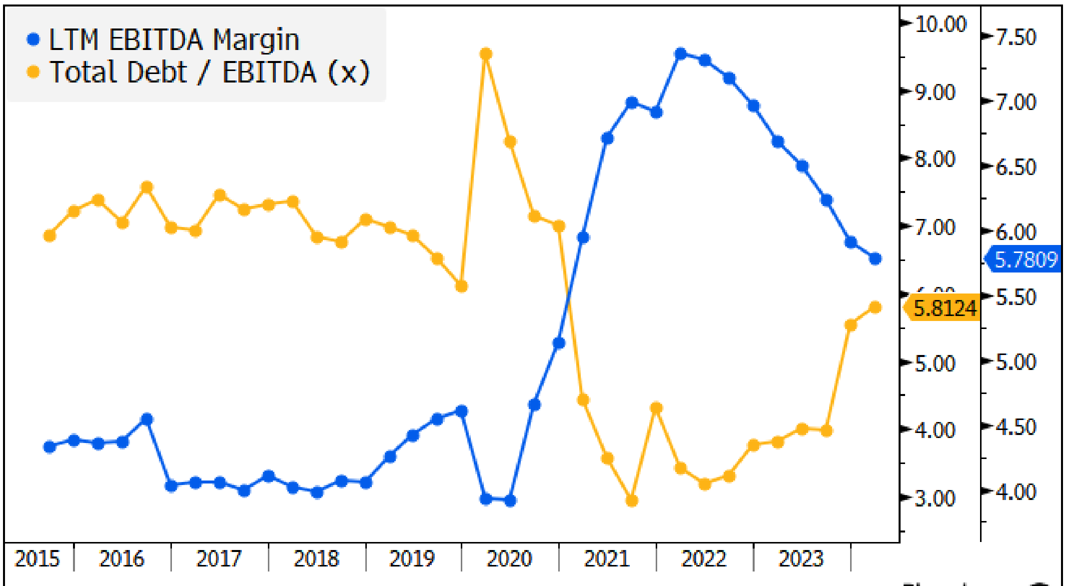


Source: Company Data, Crain Communications

Section 10. Auto Dealer Outlook

Margin Mean Reversion Melts Metrics

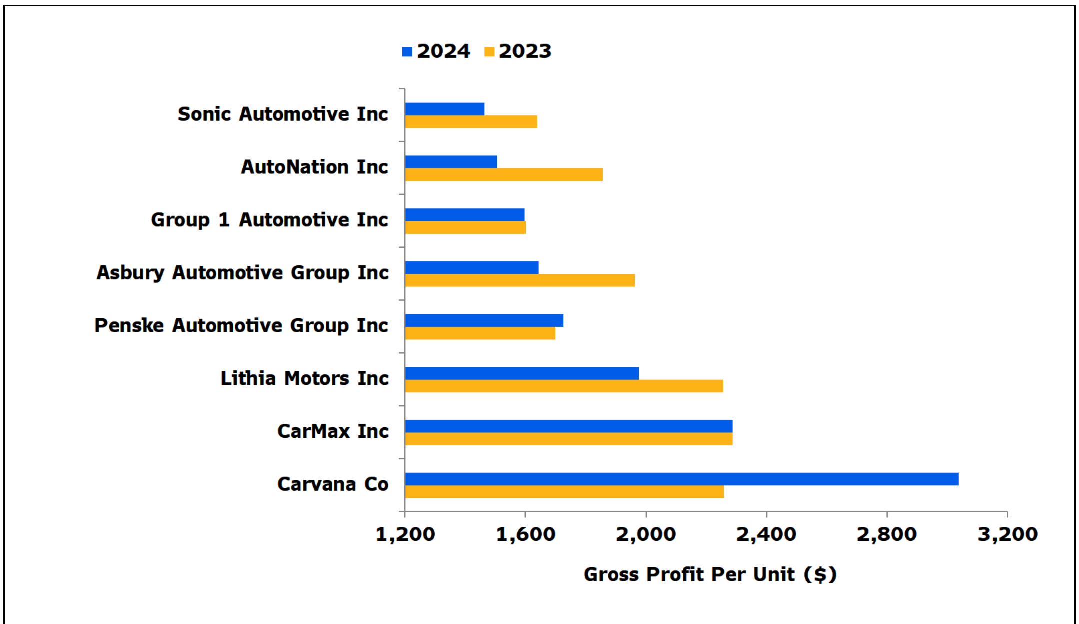
Figure 23: Margin, Leverage Trends



Source: Bloomberg Intelligence

10.1 GPU Targets Erode, Led by AutoNation, Sonic and Group 1

Figure 24: Gross Profit Per Unit (GPU) Trends



Source: Bloomberg Intelligence

10.2 $20 Billion at Risk, Led by Hertz and Carvana

Figure 25: Debt With Negative Outlooks

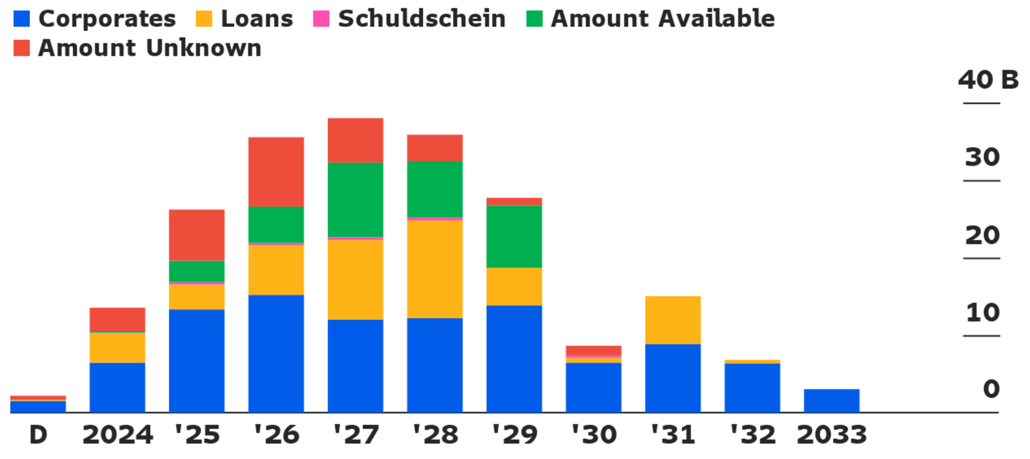
Tickers	Total	N.A.	BB+
Total	21,287	2,755	1,800
HTZ	6,845	--	--
CVNA	4,651	--	--
HARFRE	4,035	1,050	--
AAP	3,000	1,200	1,800
DYKAUT	1,160	205	--
DRVN	800	300	--
RVRETL	796	--	--

Tickers by S&P Rating
(Sum of Amt Outstanding/Tranche Size in MM)

Source: Bloomberg Intelligence

10.3 $21 Billion Debt Pile to Dig Out of in 2024

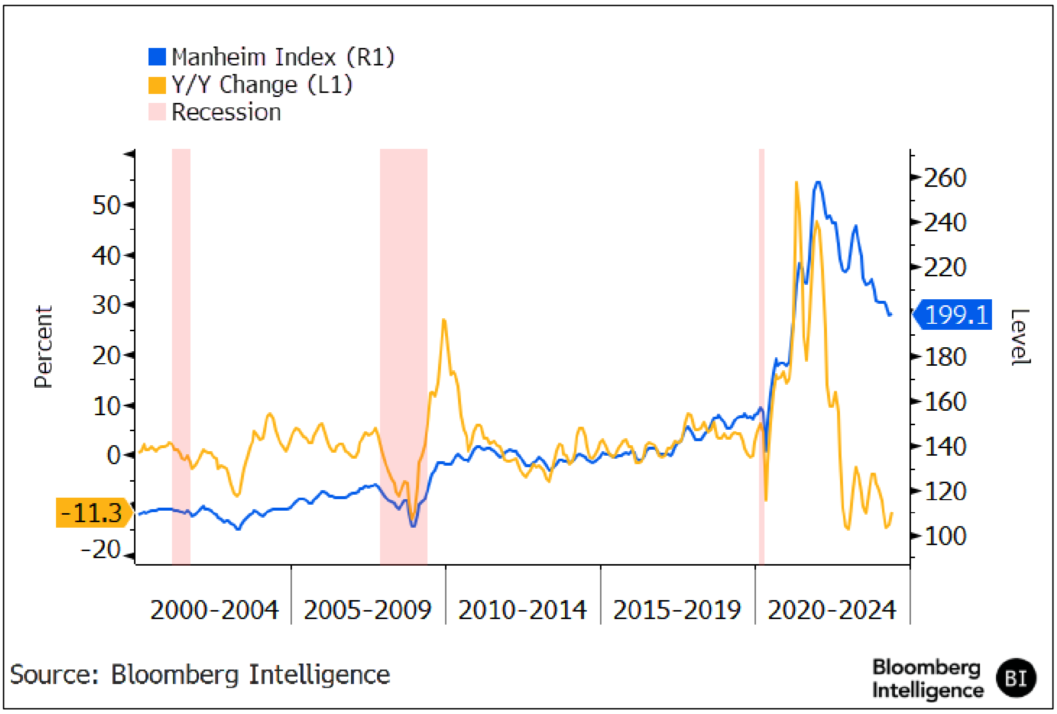
Figure 26: Debt Maturity Schedule



Source: Bloomberg Intelligence

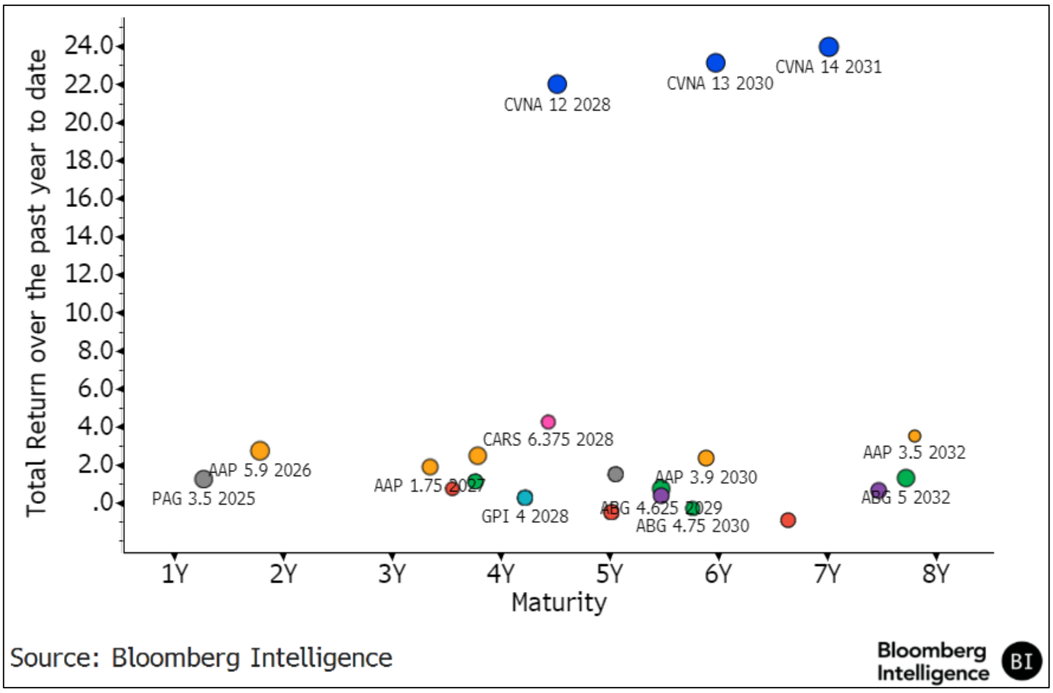
10.4 Manheim Index Tumbles More Expected in 2024

Figure 27: Manheim Index Trends



10.5 Carvana Rips as Peers Rolled to Start 2024

Figure 28: Total Returns



Section 11. Performance and Valuation

Dealer Multiples Resist Reset During Profit Spike

The shares of the peer group of six publicly traded, US-based dealer groups have risen at a 31% compound annual rate since the beginning of 2019, underpinned by a significantly tighter supply-and-demand balance in the new-vehicle market that drove dealer profitability to record highs. The companies' valuations are set to recover from cyclical lows after enterprise value-to-Ebitda multiples compressed as the market valued record earnings as a temporary condition.

11.1 Performance: Down From 2023's High

Group 1 Automotive leads the group in CAGR since the pre-pandemic period, returning 40%, with none of the competitors appreciating at a rate of less than 25% since the end of 2018. Since the global supply-chain and production disruptions that began in late 2019, the first one to reach a record share price during the cycle was Lithia Motors in March 2021, amid the tightest supply period in history. Inventory bottomed below 900,000 units by 3Q21, supporting vehicle sales above of 1 million in every month of that year. Asbury, AutoNation and Penske share prices peaked – along with the group as a whole – in July 2023. Sonic and Group 1 are still near record highs from April. The return of inventory to 3 million units industrywide has compressed dealer margins while nudging up transaction counts and providing strong recovery in ancillary revenue streams such as finance and insurance and parts and services.

The deteriorating new-vehicle profit dynamics haven't devastated the dealers' shares, though the group is 5.3% below its July 2023 peak. Lithia and Penske are the only two that have retreated double digits from record highs. Lithia is 36% below the March 2021 peak, while Penske is down 16.4% from its July 2023 crest.

11.2 Valuation: Recovering from Cyclical Lows

Automakers' cost structures are chronically inflating, making it difficult to maintain production discipline that would keep supply and demand in balance for the sake of retailers' pricing power and margin preservation. The median dealership valuation multiple of 8x in 2022 was the lowest since at least 2010, even as adjusted pretax profit per store reached a record high above $5 million.

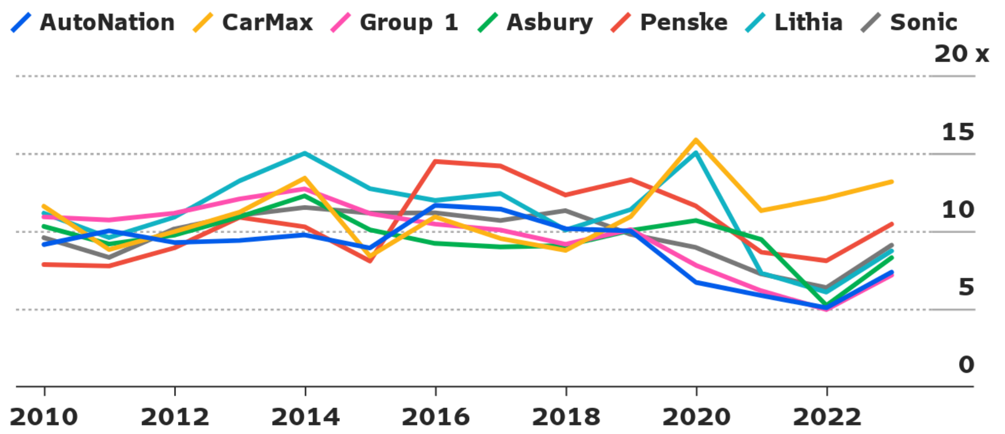
The median market cap for the peer group of automobile retailers – including pure-play used vehicle dealers CarMax and Carvana – retreated $424 million to $6.9 billion in 2023, though the EV/Ebitda multiple expanded 90 bps to 8.9x. That reflected markets' perception of earnings quality when new vehicle inventory – above 4 million units in 2019 – fell to unsustainable lows below 1 million in 2022. The tight supply left consumers paying an average of $900 a vehicle and an additional $7 billion over MSRP to retailers during 2022. The industry averaged $2,400 below sticker price from 2015-19, keeping as much as $40 billion a year out of dealerships' revenue pool.

EV/Ebitda of the peer group of full-line dealerships recovered to 8.7x in 2023 as adjusted pretax profit declined 9%, or $623 million, from the profitability peak of 2022, when the multiple bottomed at 7.3x. Penske's premium-brand focus, international presence and truck sales propelled the highest multiple, at 10.4x. Sonic Automotive was the only other retailer above 9x, and AutoNation trailed the broader group at 7.4x.

The field of used-vehicle-only retailers narrowed to two – CarMax and Carvana – as Vroom and Shift failed to achieve scale before the new-vehicle market recovered production momentum and interest rates squeezed demand for big ticket purchases. Of the two, Carvana remains the valuation anomaly, commanding a 44x EV/Ebitda multiple compared with 13.2x for CarMax – a retailer that sold 2.8x as many vehicles and generated 5.6x as much pretax income in the most recent fiscal year.

As a mature company with an established and sustainable view of profitability, CarMax's market cap and multiple have been more consistent since 2016 -- the peak volume year in the US. The company's value has contracted 1.5% annually since 2015, with an EV/Ebitda multiple that has only varied by 20 bps. By contrast, Carvana's market cap has managed a 48% CAGR since 2018, even as unit volume peaked above 605,556 units in 2020 and declined 22.5% to 469,392 in 2023.

Figure 29: EV/EBITDA



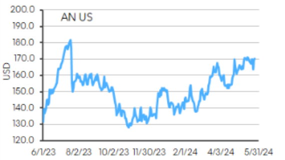
Source: Company Filings, Bloomberg Data

Section 12. Company Impacts

AutoNation Turns to Service to Ease Margin Crush

AutoNation's competitive edge stems from its scale and flexibility, allowing the company to toggle between business units as conditions change in the new- and pre-owned vehicle segments. Higher new-vehicle volume and the lowest gross margin since 1Q21 will nudge AutoNation to generate more income from parts counters and service bays in 2024. Used vehicles are expensive to acquire due to fewer new-vehicle sales and lower customer incentives -- including leasing -- since 2020.

12.1 Leading Fixed Ops Revenue and Gross Profit Per Store



Market Cap (USD Bln)		6.84
Share Price (USD)		170.25
Earnings Per Share* (USD)		P/E
2023A	23.00	7.40
2024E	18.58	9.17
2025E	19.83	8.58

* Bloomberg Consensus

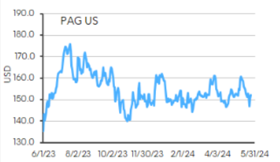
271
AutoNation locations in 2024

$2.1 Billion
2023 Parts & Service revenue

Company Outlook: Parts counters and service bays will take on a larger role in stabilizing gross profit margin.
This is needed to offset price weakness tied to overproduction and excess inventory in the new-vehicle segment and contracting margin in pre-owned sales. AutoNation's segment-leading store count, with 51% in vehicle-dense California, Florida and Texas, makes it the service gross profit leader at $2.1 billion in 2023. Penske's 59% gross margin is the widest of the peer group.

Profit Impact: AutoNation generated $16 million per store in parts and service revenue in 2023, turning into $7.9 million in gross profit per rooftop from warranty and customer-pay repairs and maintenance. Both numbers lead publicly traded dealers, though AutoNation ranked third in store count at the start of 2024.

12.2 Penske's Premium Focus a Fit for Expensive EVs



Market Cap (USD Bln)		10.25
Share Price (USD)		152.10
Earnings Per Share* (USD)		P/E
2023A	16.10	9.45
2024E	13.45	11.31
2025E	13.89	10.95

* Bloomberg Consensus

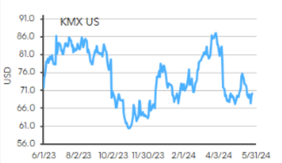
58.7%
Penske Parts & Service gross margin in 2023

$62,134
Penske revenue per new vehicle in 2023

Company Outlook: Penske's revenue diversity underscores its ability to shift focus to its growth segments as conditions warrant. Service operations and parts sales, the margin drivers, are ratcheting up in profit importance. Recovering volume and rising inventory are enabling growth in volume and revenue in most segments, with the other side of the trade resulting in compressed gross margin for new and used vehicles. Elevated interest rates have more than offset the benefit of floorplan assistance paid by manufacturers net of increased borrowings.

Revenue Impact: Penske gets 41% of new-vehicle revenue from premium German brands Audi, BMW and Mercedes, commonly tightly supplied, though the commitment to BEVs in the slow-to-adopt US market is driving up inventory. US-based pure-play BEV manufacturers Lucid, Rivian may look to the existing franchised dealer base for immediate and experienced sales, distribution and aftersales support in a bid to achieve profitable scale. Both brands carry transaction prices well above the industry average near $48,000, making them good fits with Penske's premium brand focus.

12.3 CarMax Plods as Supply and Purse Strings Tighten



Market Cap (USD Bln)		11.08
Share Price (USD)		70.26
Earnings Per Share* (USD)		P/E
2024A	3.02	23.26
2025E	3.13	22.48
2026E	3.85	18.25

* Bloomberg Consensus

1,312,000
Total pre-owned vehicles sold in fiscal 2024

$2,288
Retail used vehicle gross profit

Company Outlook: CarMax, the used-vehicle segment leader, is intensifying its digital capabilities in vehicle acquisition and distribution as increasingly cautious buyers damage the margin dynamics, with quality used vehicles persistently expensive to put into inventory. Carvana -- the leader in online-only sales -- has its second wind and may return to prioritizing volume over unit economics. The favorable new-car margins that pulled the focus of some full-line dealer groups away from the used-vehicle market are starting to lose steam, positioning CarMax against well-funded competitors as demand flags due to higher interest rates, tight supply and tentative consumers.

Margin Impact: A drop in off-lease autos entering the used-vehicle pool means a market that historically subsidized full-line dealers' low-margin new-auto sales has lost its profit punch, and inventory acquisition costs will stay near record highs near term. The segment's gross margin has compressed an average of 350 bps below new vehicles in 2021-23, turning away full-line dealers, while pure-plays CarMax and Carvana are forced to overpay for inventory. The used-vehicle pure-plays have no recourse other than to ride out the segment dynamics, unable to acquire franchised stores or open-point dealerships from new brands entering the US. CarMax has no parts and service operations, eliminating the ability to generate gross profit from the largest contributor to the full-line dealer groups' income statement.

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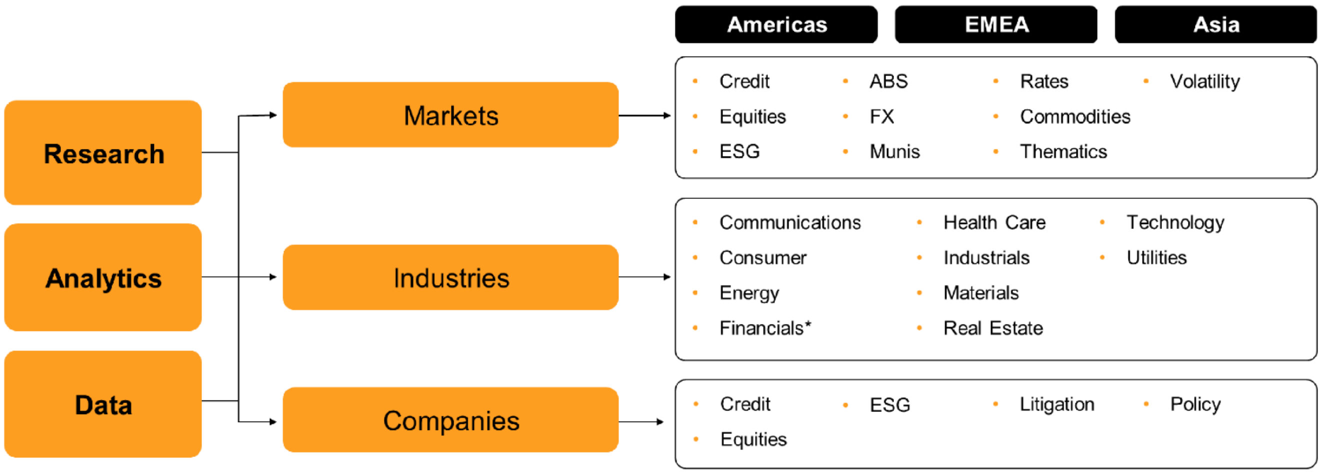

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