THE BLUE SKY REPORT®

A KERRIGAN QUARTERLY

First Quarter 2022

June 2022

Kerrigan Advisors

Contact Erin Kerrigan: (949) 439-6768 | erin@kerriganadvisors.com

Contact Ryan Kerrigan: (949) 728-8849 | ryan@kerriganadvisors.com

www.KerriganAdvisors.com

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The Premier Sell-Side Advisor to Auto Dealers in Florida

Kerrigan Advisors' Recently Completed Transaction: Fuccillo Kia of Clermont

KERRIGAN ADVISORS REPRESENTED

FUCCILLO AUTOMOTIVE GROUP

KIA

CLERMONT, FLORIDA

IN ITS SALE TO

MORGAN AUTOMOTIVE GROUP

JUNE 2022

IT'S HUGE! FUCCILLO AUTOMOTIVE GROUP

KIA
PORT CHARLOTTE, FL
Sold March 2021
WESLEY CHAPEL, FL
Sold January 2020
CAPE CORAL, FL
Sold March 2021

NISSAN
JACKSONVILLE, FL
Sold December 2019
CLEARWATER, FL
Sold August 2021

FIELDS AUTO GROUP

LAND ROVER
ORLANDO, FL
Sold January 2021

VOLVO
DAYTONA, FL
Sold February 2020

CHRYSLER Jeep DODGE RAM
SANFORD, FL
Sold January 2021

VW
DAYTONA, FL
Sold February 2020

"I needed advisors who are professionals when it comes to selling dealerships. That's what I got with the team at Kerrigan Advisors."

BILLY FUCCILLO JR.
President of Fuccillo Automotive Group

Kerrigan Advisors is the most experienced sell-side advisor in Florida, having recently represented on the sale of 10 dealerships in the state. Our team understands the strength of the Florida market and the unique drivers of dealership valuations.

If you would like to learn more about the firm, please contact Erin Kerrigan or Ryan Kerrigan at (775) 993-3600 or visit KerriganAdvisors.com.

KERRIGAN ADVISORS

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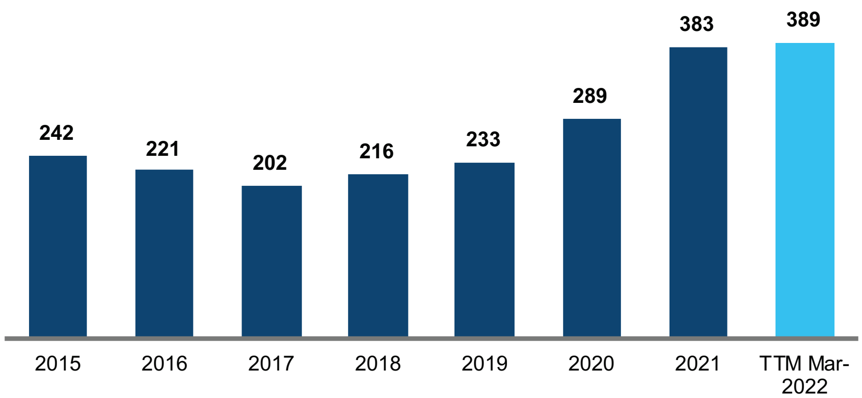
EXECUTIVE SUMMARY

The dealership buy/sell market in 2022 launched with a strong start, outpacing 2021's record pace in the first quarter. As a result, in the last 12 months, a record 389 transactions closed, representing 829 franchises (see Chart 1). If this pace continues, nearly every dealership in the US would trade hands in the next 20 years, leading to fewer single point dealers and a much higher concentration of vehicle sales amongst the leading consolidators.

Chart I | Number of Completed Dealership Transactions

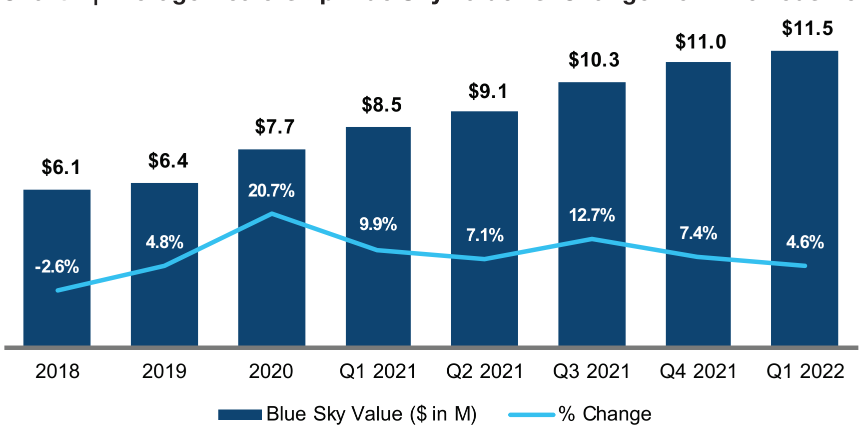


Source: The Banks Report, Automotive News, Kerrigan Advisors' Research

The 2022 buy/sell market started strong, with the first quarter of 2022 outpacing the first quarter of 2021, leading to a record 389 transactions closing through the trailing 12 months as of March 2022. If this pace continues, nearly every US dealership would trade hands in the next 20 years.

During the quarter, average dealership blue sky value increased to a new record of $11.5 million (see Chart 2), an improvement of 4.6% relative to the fourth quarter of 2021. This increase was driven by another rise in quarterly profits, which surpassed 2021's first quarter by an estimated 27% (see Chart 3 on the following page). While this valuation increase was significant, Kerrigan Advisors expects blue sky values to rise at a slower pace in the coming quarters as buyers see economic headwinds on the horizon, including rising interest rates (a trend discussed further on page 18).

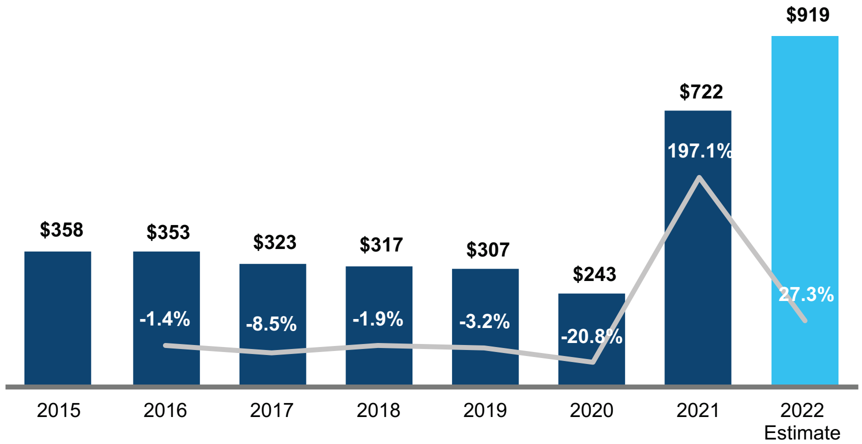
Chart 2 | Average Dealership Blue Sky Value vs. Change from Previous Period, $ in Millions



Source: NADA, Kerrigan Advisors Research & Analysis

Rising dealership profits helped drive average dealership blue sky values to a record $11.5 million in the first quarter of 2022, a 4.6% increase over the fourth quarter of 2021. With economic headwinds on the horizon, Kerrigan Advisors expects blue sky values to rise at a slower pace in the coming quarters.

Chart 3 | Average Dealership First Quarter Pre-Tax Profit, $ in 1,000s

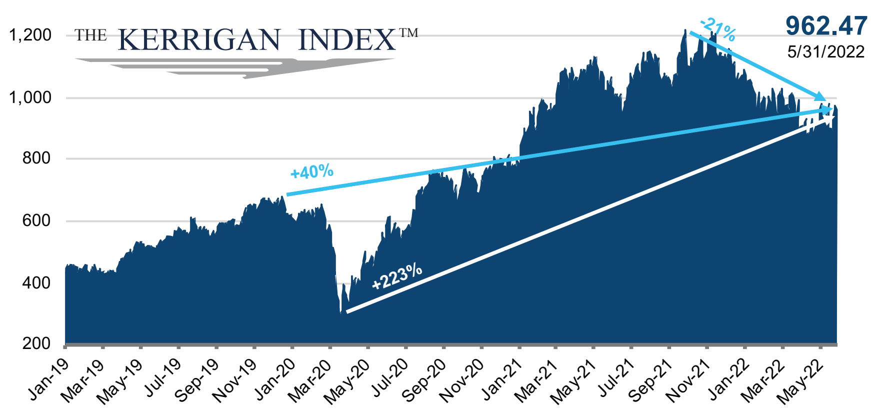


Dealership pre-tax profits continued to rise in the first quarter of 2021 to a record $919,000 on average, an estimated 27% increase quarter over quarter.

Source: NADA, Kerrigan Advisors Research & Analysis, SEC Filings for Asbury, AutoNation, Group 1, Lithia, Penske & Sonic

The public markets are also messaging their expectation that future industry earnings may decline if consumer demand softens. The Kerrigan Index™ of the seven publicly traded auto retailers is down 21% from its peak in September 2021 through May 31st (see Chart 4), despite these companies achieving record quarterly profits (see Chart 5 on the following page). Notably, the Index is still up an impressive 223% from its March 2020 lows, outperforming the S&P 500 by 165% during that period and is 40% higher than its 2019 high.

Chart 4 | The Kerrigan Index™, January 2019 to May 2022

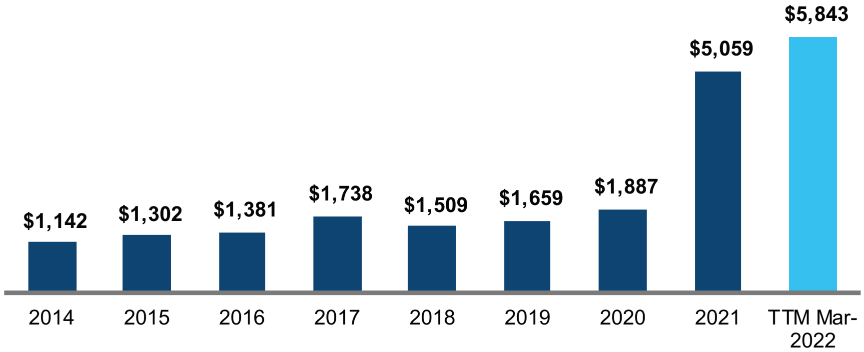


The Kerrigan Index is up 223% from March 2020 lows, outperforming the S&P 500; however, it is down 21% from its 2021 peak, reflecting public market concern about softening consumer demand.

Source: Yahoo Finance, Microsoft Finance, Kerrigan Advisors' Analysis

Methodology: The Kerrigan Index™ is composed of the seven largest publicly traded auto retail companies with operations focused on the US market, including CarMax, AutoNation, Penske Automotive Group, Lithia & Driveway, Asbury Automotive Group, Group 1 Automotive and Sonic Automotive. **The Kerrigan Index™ is weighted by the market capitalization of each company and benchmarked at 100 on 1/3/2000.**

Chart 5 | US Public Dealer Groups' Net Income, $ in Millions



Source: SEC Filings for Asbury, AutoNation, Group 1, Lithia, Penske & Sonic

The public retailers continue to experience record quarterly profits, collectively over $5.8 billion through the trailing 12 months as of March 2022.

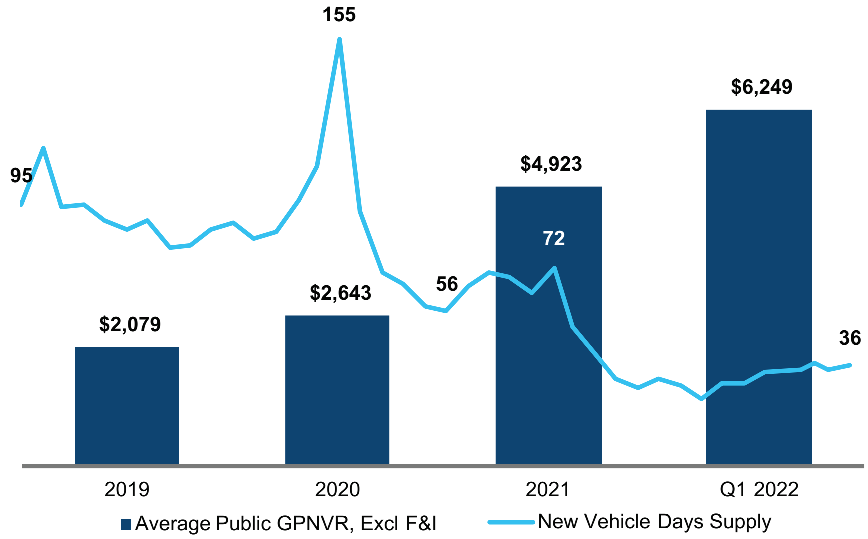
> *"In a challenging new vehicle environment, we delivered record profitability by improving our new vehicle margin, increasing our used vehicle sales and growing our parts and service business, all while maintaining our improved employee productivity levels and using our strong cash flow for acquisitions."*
>
> ***David Hult, President & CEO, Asbury Automotive Group***
> ***First Quarter 2022 Earnings Call***

In the near term, auto retail may benefit from today's inflationary environment as the price of consumers' trade-in vehicles appreciates providing higher levels of vehicle equity. Also, given the industry's high variable cost structure, inflationary costs do not immediately impact the operational expenses of a dealership, as most expenses are determined as a percentage of gross profits. As a result of these structural advantages against inflation combined with pent-up consumer demand and improved operational efficiencies from technology, Kerrigan Advisors expects auto retail earnings will outperform the broader US retail market this year, giving both public and private dealers tremendous cash flow to continue their acquisition expansion plans.

> *"Right now, we're a plane taking off and we're in the clouds. It's a little bumpy and everyone can't see above the clouds yet. But when we get above the cloud in the next 18 to 24 months, I think things are going to look really good for our industry as a whole."*
>
> ***David Hult, President & CEO, Asbury Automotive Group***
> ***First Quarter 2022 Earnings Call***

With this in mind, the vast majority of dealers today are buyers, not sellers. In fact, the first quarter's record industry profits are causing some dealers who were considering a sale to reassess their plans. While most dealers expect dealership earnings to eventually normalize at lower levels in the future, there are questions around the timing of that normalization, particularly as days' supply of inventory plummets, resulting in continued increases in gross profits per new vehicle retailed (see Chart 6 on the following page).

Chart 6 | Days Supply of New Vehicle Inventory vs. Average US Public Dealer Groups' Gross Profit per New Vehicle Retailed, Excluding F&I

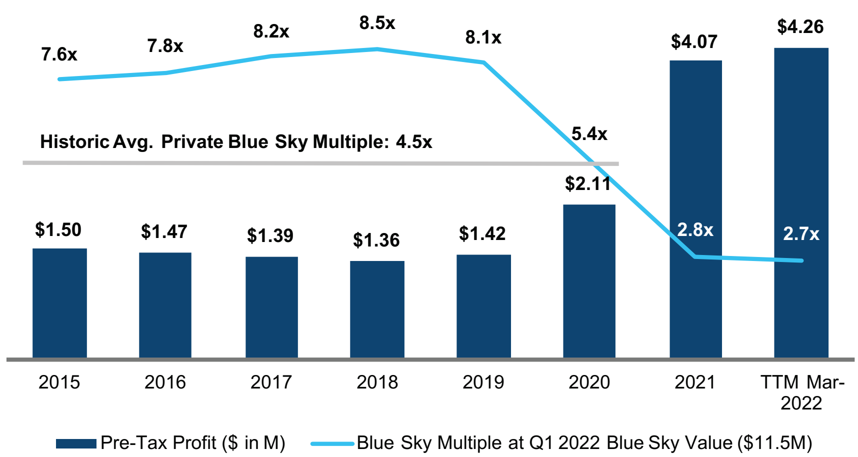


Source: SEC Filings for Asbury, AutoNation, Group 1, Lithia, Penske & Sonic, Wolfstreet.com, Cox Automotive

Days supply of new vehicle inventory declined to 36 in April 2022, fueling a rise in gross profits per new vehicle retailed to an average of $6,249 for public dealership groups.

The paradox of today's record blue sky values lies in their earnings comparison. Blue sky multiples relative to pre-pandemic earnings are extraordinarily high, averaging 47% above past industry averages. By contrast, blue sky multiples relative to current earnings are very low. Dealers who sell today are willing to forego the potential continuation of elevated profits in exchange for the opportunity to potentially top-tick the market in valuation. That said, the longer dealership earnings defy expectations the harder it is for sellers to justify a sale price, even at today's elevated blue sky levels (see Chart 7).

Chart 7 | Average Dealership Pre-Tax Profit ($ in Millions) vs. Blue Sky Multiple at Q1 2022 Average Blue Sky Value of $11.5 Million

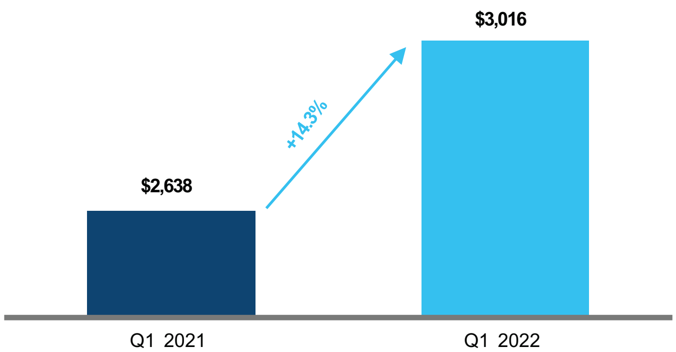


Source: NADA Industry Analysis, Kerrigan Advisors' Analysis

Blue sky multiples, relative to today's high earnings, are low; however, when compared to pre-pandemic earnings, valuations are extremely high and multiples are nearly double historic averages.

While Wall Street is clearly signaling an expectation that future profits will decline in auto retail, for the most part, dealers are more optimistic than Wall Street. Despite rising economic risks on the horizon, most dealers are confident in the strength of today's dealership business model which has historically remained profitable even during periods of recession. These dealers know that when new vehicle sales decline, consumers often require more service for their existing vehicles. Fixed operations is the highest margin business segment in auto retail, averaging nearly 50% in gross margin. Through the first quarter, the publics' fixed operations sales on a same-store basis rose an impressive 14.3% compared to the first quarter 2021 (see Chart 8). A rebound in miles driven combined with the aging of the US vehicle fleet (see Chart 9) is expected to create a significant tailwind for auto retail earnings in 2022 and beyond, even if consumer demand for vehicles eventually softens.

Chart 8 | US Public Dealer Groups' Same-Store Fixed Operations Sales, $ in Millions

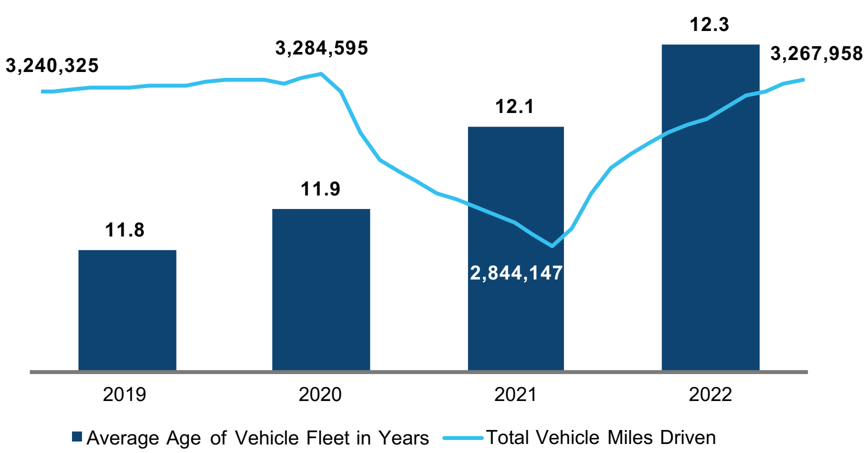


The publics' fixed operations sales grew 14.3% in the first quarter of 2022. Continued growth is anticipated in this high margin business segment, fueling dealer confidence, even as economic risks loom.

Source: SEC Filings for Asbury, AutoNation, Group 1, Lithia, Penske and Sonic

> *"I think we have a good run rate in this countercyclical fixed ops business."*
>
> ***Chris Holzshu, Chief Operating Officer, Lithia & Driveway***
> ***First Quarter 2022 Earnings Call***

Chart 9 | Total Vehicle Miles Driven in US vs. Average Age of Vehicle Fleet in Years



Miles driven rebounded in 2022 as the average age of vehicles rose to 12.3 years, generating a potential earnings tailwind from increased vehicle service revenue in 2022 and beyond, even if consumer demand softens.

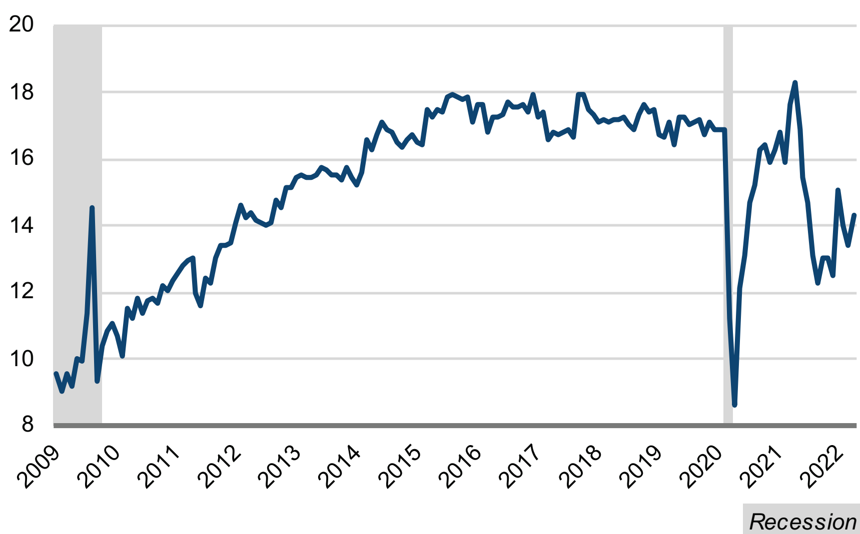
Source: IBIS World, US Federal Reserve Bank of St. Louis

> *"I would say we're seeing more miles driven. There's no question because the country has opened up, which is driving more mileage, which will drive more parts and service."*
>
> ***Roger Penske, Chairman & CEO, Penske Automotive Group***
> ***First Quarter 2022 Earnings Call***

Furthermore, while Wall Street is skittish about the consumer's ability to absorb higher living costs and rising interest rates, the pent-up demand for vehicles remains considerable. Today's sales rate (see Chart 10) is consistent with recessionary periods. These lower sales rates are due to a lack of new vehicle supply, rather than a dearth of consumer demand. While some consumers are turning to alternative sources to satisfy their transportation needs, including buying out their leases and purchasing used cars, significant pent-up demand remains in the new vehicle market.

> *"Demand would have to come down on new vehicles a long way before it got anywhere close to supply."*
>
> ***Earl Hesterberg, President & CEO, Group 1 Automotive***
> ***First Quarter 2022 Earnings Call***

Chart 10 | Light Vehicle Sales, Seasonally Adjusted Annual Rate, in Millions



Light vehicle sales rates dropped in 2022 as a result of low supply, not demand. Pent up consumer demand is expected to sustain strong new vehicle sales for the foreseeable future.

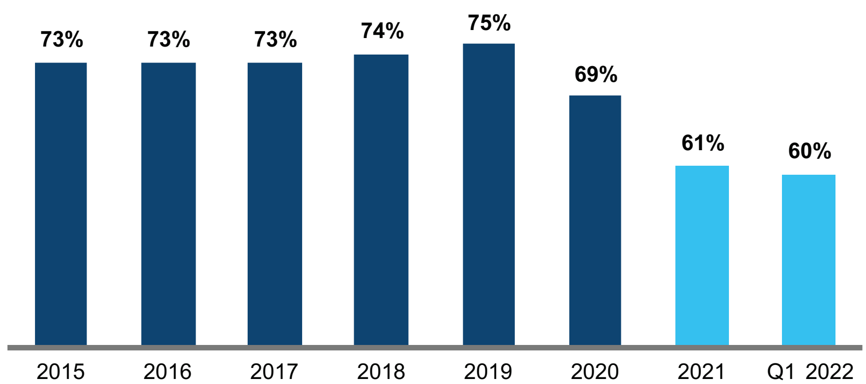
Source: US Federal Reserve Bank of St. Louis

> *"We think about the start of last year, we were at about three million units of dealer inventory at large and now we're just over one million units. So as we think about the course of this year even if the automakers huff and puff, it's hard to believe they're going to get anywhere near normal on inventory and the chips don't exist."*
>
> ***John Murphy, Managing Director & Lead US Auto Analyst in Equity Research, Bank of America***
> ***February 10, 2022***

Auto retail's flexible cost structure also enables the business to adjust quickly to changes in the marketplace. As a result of the pandemic, dealers have increased employee productivity, reducing their reliance on human capital and increasing their utilization of technology. The average revenue per dealership employee has risen over 27% from pre-pandemic periods, driving sales, general and administrative (SG&A) expenses down as a percentage of gross profit (see Chart 11). Kerrigan Advisors expects improved productivity will further sustain higher dealership profitability even if the economy enters a period of recession.

> *"So we expect that we will continue to have a much more favorable SG&A as a percentage of gross going forward by maintaining discipline and ensuring that we continue to leverage the [technology] tools most effectively."*
>
> ***Joe Lower, Executive VP & CFO, AutoNation***
> ***First Quarter 2022 Earnings Call***

Chart 11 | US Public Dealer Groups' SG&A Expense as a Percentage of Total Gross Profit



Pandemic-driven improved employee productivity has driven revenue per dealership employee up, lowering SG&A expenses to 60% of total gross profit for the public retailers in the first quarter of 2022.

Source: SEC Filings for Asbury, AutoNation, Group 1, Lithia, Penske and Sonic

> *"We've proven our business model is one that when gross profit generation reduces, we have to reduce our cost, but we have a flexible cost structure. And that's what we continue to prove in recessions…and that is the advantage of our business model."*
>
> ***Earl Hesterberg, President & CEO, Group 1 Automotive***
> ***First Quarter 2022 Earnings Call***

With this overview, 2022 is expected to be another very active year for the buy/sell market, constrained only by the supply of dealerships for sale. While potential economic headwinds are roiling the financial markets, industry tailwinds are expected to support a highly profitable auto retail market. As a result, valuations are projected to remain high throughout the year.

In addition to the trends noted in our 2021 Annual Blue Sky Report, Kerrigan Advisors has identified the following three important trends we expect to meaningfully impact the buy/sell market for the remainder of 2022.

- **Buyer demand for Toyota and Lexus franchises far surpasses other franchises**
- **Rising interest rates expected to temper blue sky and real estate appreciation**
- **Industry fragmentation provides acquisition opportunities for groups seeking market leadership**

The Blue Sky Report® is informed by Kerrigan Advisors' nationwide experience enhancing the value of the industry's leading dealers through the lifecycle of growing, operating, and selling their businesses. Since our founding, Kerrigan Advisors has had the distinct honor of representing the industry's largest transactions, including more Top 150 Dealership Groups than any firm in the industry.

Our team oversees and manages our client engagements from beginning through a successful outcome. In our view, *dealerships are far too valuable to be advised any other way*. Kerrigan Advisors does not take listings, rather we develop a customized sales approach for each client to achieve their transaction and financial goals. Our professional sale process, which includes the support of our entire firm, has led to *the highest sale price per transaction of any firm over the last five years*. We hope you find the information presented in this quarter's report helpful to your business. We look forward to answering any questions you may have regarding The Blue Sky Report, The Kerrigan Index or Kerrigan Advisors' advisory services.

To have a confidential conversation with our managing directors, please contact us. We look forward to connecting with you.

Erin Kerrigan, erin@kerriganadvisors.com, (949) 439-6768
Ryan Kerrigan, ryan@kerriganadvisors.com, (949) 728-8849

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