Dave Cantin Group

KAISER ASSOCIATES

US RETAIL AUTOMOTIVE

2024 Market Outlook Report Mid Year Update

Introduction to the Market Outlook Report: The Dave Cantin Group partners with Kaiser Associates to take a 360° look at the trends that matter in the U.S. auto market

Dave Cantin Group

The Dave Cantin Group is a leading Automotive M&A advisory company with access to specific informed transactional and market data. Through a partnership with Kaiser Associates DCG can provide deeper data sets to allow **automotive leaders and influencers to make smarter decisions** in a continuously changing environment.

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	BUSINESS NEEDS			
CAPABILITIES	Growth Opportunities	Go To Market Approach	Performance & Productivity	M&A and Corp Dev
Market Analysis & Structural Attractiveness				
"Voice of the Market"				
Benchmarking & Best Practices				

Kaiser Associates is a global growth consulting firm.

We help translate **original insights into strategy** for ambitious organizations around the world.

*Our research team drew from Kaiser's **Industrial Goods, Consumer, Supply Chain,** and **M&A practices**. For further information, please contact:*


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Checking in on the state of U.S. retail automotive at the midpoint of 2024

The U.S. automotive industry has had an **exceptional last few years** and started 2024 on a path back to a "new normal." For our 2024 Market Outlook Report, Kaiser Associates attempted to capture the state of the industry at the start of the year (from the perspective of manufacturers, dealerships and consumers) and found **seven forces** that were top of mind & shaping the industry.

At the **midpoint of 2024, we wanted to check back in** and assess what has changed, what remains top of mind, and how industry participants are operating in the current environment. For this update, we're focusing **primarily on the dealerships**, because this is where the industry intersects on a daily basis.

To inform our mid-year update, we drew from conversations with industry players, deep secondary research, informed opinions from the DCG team as well as a **dealer sentiment survey** completed at the start of July that captures the pulse of dealership owners and managers around the country. We are grateful to everyone who participated in the survey, and look forward to capturing your feedback again next year.

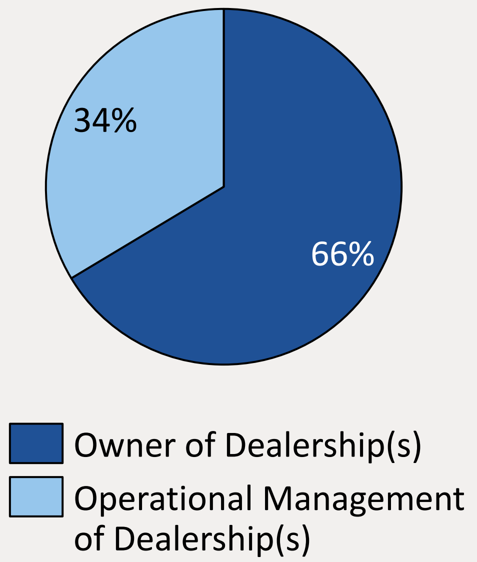
As always, we hope this update is informative and useful.

- The Kaiser Associates Market Outlook Report Research Team

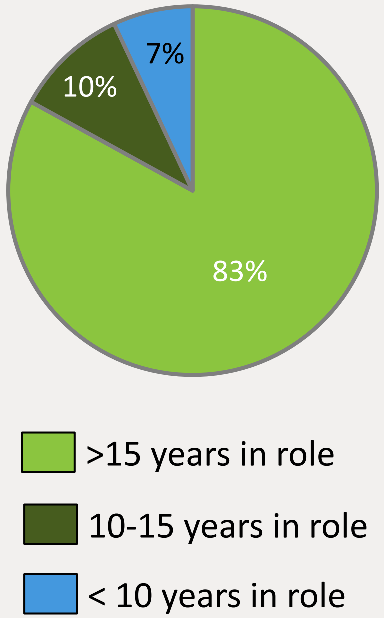
U.S. Dealership Owner Survey (Q2 2024)

Our July 2024 U.S. Dealer survey collected responses from owners & managers of dealerships across the U.S. More than 90% of respondents have been in the industry for > 10 years.

Split by Role



Tenure in Role



Checking on 2024's key themes: Halfway through the year, the 7 forces we saw at the start of 2024 continue to shape the industry

The 7 Themes to Watch in '24	What's happened at the midpoint of the year?	Impact on Dealerships?
EVs	2024 has seen the **beginning of clarity** for the industry. There are emerging winners (e.g., Rivian, Vinfast) and losers (Fisker), Tesla is in a better position than it may appear despite Q2 earnings and we're seeing signs that EV may be the growth driver the industry was hoping for.	More opportunity
Dealership Performance	Retail auto dealerships are "back to the grind" as the COVID effect wears off. "Mom and pop" owners have to **work harder to compete** as larger dealerships invest in performance.	More challenges
M&A Trends & Forecast	2024 continues to be a very active year for M&A, but valuations are moving lower and it's a buyer's market. **The risks of waiting to sell are greater in 2024** than in recent years.	More opportunity
OEMs & Supply Chain	Supply chains have held up against headwinds in 2024 – but **this is a problem for dealers** as inventory piles up. We believe inventory levels will be at 2019 levels by the end of the year.	More challenges
Politics & Regulation	2024 is even more politically volatile than we had predicted. We think election developments and Supreme Court decisions are likely going to be **positive for the U.S. auto industry.**	More opportunity
Consumer Trends	**Consumers have hit a limit** when it comes to ability to pay top dollar for cars. A big question is whether falling rates (when, not if) will be enough to change that.	More challenges
Macroeconomics	Interest rates were the primary concern at the start of the year, and are the top concern at the midpoint as well. **Dealers have to make hard choices** to prioritize in a tough environment.	No Change

EV Trends: The first half of 2024 has seen high-profile OEM bankruptcies, major production misses, and continued cooling of consumer demand for BEVs

Start of Year Perspective

1. **EV demand stagnates despite subsidies**
2. **OEMs reflect varying attitudes in EV production strategy**
3. **Chinese OEM entrance not likely until 2025**
4. **EV pricing has potential to become increasingly competitive**

What's Happened Since?

- ***Winners and losers:*** EV OEMs are seeing shakeups:
  - *Winners:* **Rivian** announced a JV with **Volkswagen** in June (joint effort to leverage Rivian's software development for Rivian and VW autos). **Vinfast** announced 12 new U.S. dealers (bringing U.S. total to 18).
  - *Loser:* After failing to secure a lifeline investment from an unnamed automaker in February, and consistent challenges hitting production targets, **Fisker** filed for bankruptcy protection in June. U.S. dealership impact will be limited (only 15 locations).
- ***Tesla sales fall despite price cuts:*** global sales fell for the second quarter in a row in Q2 despite price cuts and low-interest financing; volume fell almost 5% YoY.
- ***Hybrid interest remains largely unaffected by BEV struggles:*** Kaiser's Q2 dealer survey indicates that the share of new vehicle revenue from hybrid vehicles (HEV) has grown moderately year over year, while battery electric (BEV) is slower.

DCG's Retail Automotive Takeaways

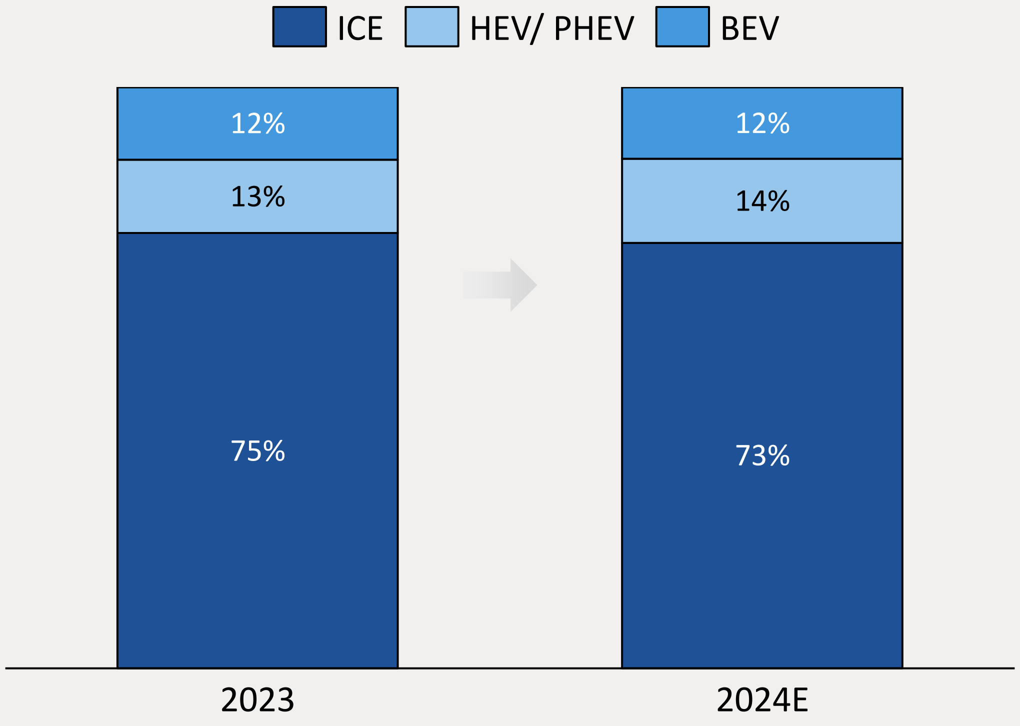
- **EVs will be just fine**. The "disappointing" performance of the EV sector was based on absurd expectations created by manufacturers and hyped in the media. EV adoption is progressing at a pace similar to other consumer products: launch, hype, early adopters - then consumers dictate the long-term position for the product in the industry.
- **The year 2024 has been an incredible year of clarity for EVs. Here's how the segment is settling into its place:**
- EV are now a critical (and growing) part of the product mix (GM +50%, Ford + 61%) but EVs are not a one-size-fits-all solution (and won't be for many decades).
- The franchise dealer model is the rule for carmakers (see VinFast), despite exceptions like Tesla.
- Traditional manufacturers are realizing it's better to "buy than build" and startups realize they don't have the financing and infrastructure to compete. **Look for more investments/acquisitions like VW's in Rivian.**
- **Don't bet against Tesla; watch what Toyota is doing.**

Source: Kaiser Primary and Secondary Research & Analysis; DCG Data insights / JIQ
[1] See appendix for Expected Impact Definitions

EV Trends: Customer interest and economics continue to slow EV adoption – but ~40% of dealerships are willingly prioritizing HEV/BEV for diversification benefits & access to credits

Who's Selling ICE, BEV, or HEV?

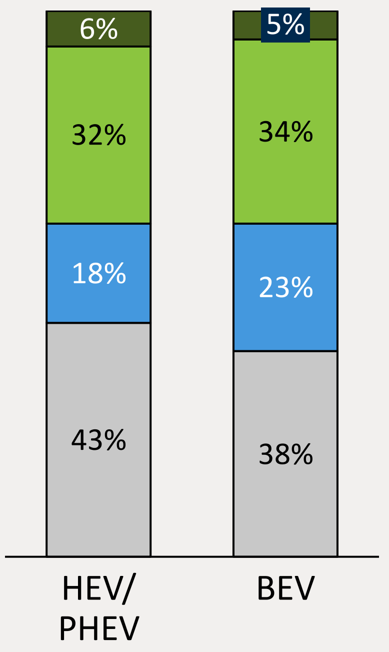
Q: What percentage of your dealership(s) new vehicle sales were each of the following engine types in 2023 and 2024?



Since last year, **dealers are reporting that BEVs / HEVs have taken roughly 2% points of unit share** – but **most of that gain is coming from hybrids**, not battery electric.

Why Prioritize BEV/HEV Models (Or Not)?

Q: How would you define the sale of HEVs/ PHEVs/ BEVs as they relate to your dealership(s) business?



Dealers who prioritize BEV/HEV sales are doing so primarily to **diversify their portfolio** (*most common reason*) and to access **tax credits and incentives** *(second most common reason).*

Dealers who do <u>not</u> prioritize BEV/HEV sales believe that customers **are not actually interested in environmental standards** *(most common)* and find **BEV/HEV price points unattractive** *(second most common).*

- We prioritize selling them
- We will sell them only if a customer indicates a strong preference
- We will gladly sell them if a customer indicates interest
- We do not sell them/ we rarely sell them

Source: Kaiser Associates Q2 2024 Dealership Survey

Dealership Performance Trends: Dealerships are seeing solid results in 2024 to date … but they have to "work harder for it;" expectations are cautiously optimistic for the rest of the year

Start of Year Perspective	What's Happened Since?	DCG's Retail Automotive Takeaways

1 Higher dealership margins offsetting declining volume
2 Parts and service likely to become the "golden egg"
3 Consumers are actively exploring deals at multiple dealerships
4 Dealers have to make a bet on the best path forward in 2024
	• ***Profitability expectations are not evenly distributed:*** At the midpoint of the year, dealerships are expecting a slight decline in profitability in 2024 vs 2023 – but still expect profitability to beat pre-COVID averages.
	  • Profitability expectations are correlated with dealership scale: The largest dealerships are the most bullish: 33% of dealers with > $150M revenue expect profitability will remain higher than pre-COVID levels (only 11% believe profitability will settle below pre-COVID levels).
	  • Smaller dealers are facing more headwinds: ~65% of dealers with revenue <$50M expect profitability will settle below pre-COVID levels - and if so, they expect these margins will be harder to maintain.
	• ***As expected, ancillary services are increasingly top of mind for dealerships looking to stand out:*** Parts and Service and Finance and Insurance are viewed as increasingly important (for 85% and 75% of surveyed dealers, respectively).
		• The automotive industry is back to the pre-Covid grind, and dealerships aren't immune to the more challenging environment.
		• **The "easy money" is over:** large, hands-on operators have staffed teams that are managing every aspect of dealer operations, positioning them to maintain profit margins in 2024. **Owner operators need to be hands-on to stay in the game**.
		• Significant dealer consolidation over the past three years, and more readily available data, has shifted power away from small dealerships to larger, more sophisticated dealer organizations.
		• **2024 will be the tipping point for smaller "mom and pop" dealerships,** many of which will struggle to compete and maintain profitability leading them to make some tough choices.

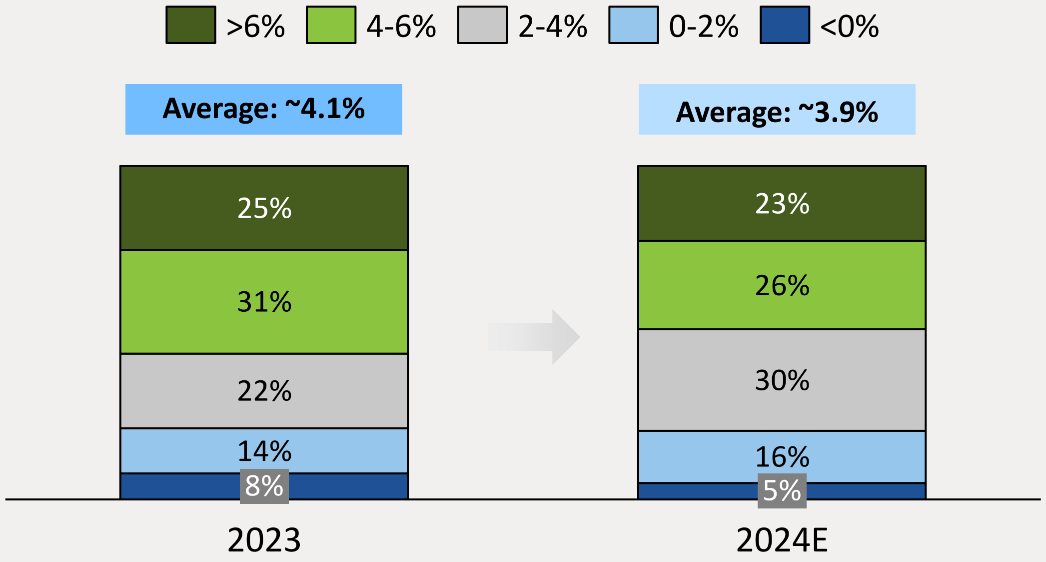
Source: Kaiser Primary and Secondary Research & Analysis; DCG Data insights / JIQ

[1] See appendix for Expected Impact Definitions

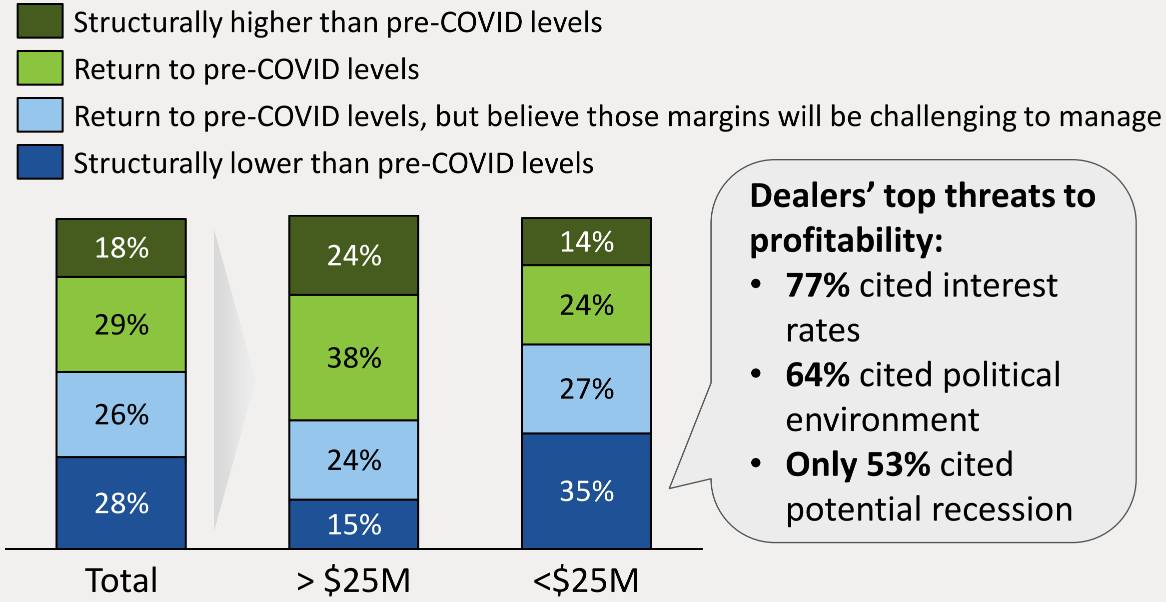
Dealership Sentiment: Even while expecting ’24 profitability to slip slightly vs ’23, dealer sentiment is generally upbeat when it comes to maintaining profitability at or above pre-COVID levels

Profitability Overview and Outlook

Q: What was the pre-tax profit margin of your dealership(s) in 2023? What do you expect the pre-tax profit margin it to be in 2024?



Q: Which of the following statements best describes your outlook towards profitability for your dealership(s)?



Dealers’ top threats to profitability:

- **77%** cited interest rates
- **64%** cited political environment
- **Only 53%** cited potential recession

85% of large dealers expect ’24 profits to be **at or above COVID levels**

35% of smaller dealers expect ’24 profits to be **below COVID levels**

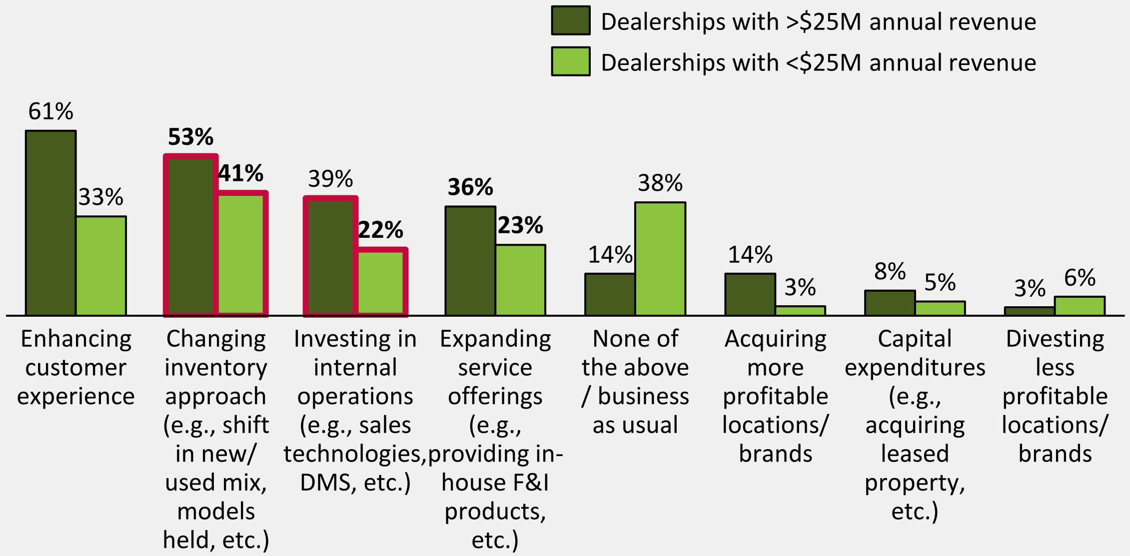
Source: Kaiser Associates Q2 2024 Dealership Survey

Performance Management: Dealerships are slightly more focused on profitability than revenue growth; larger dealerships are looking at internal ops as carefully as they are customer experience

Dealership Profitability and Revenue Growth Measures

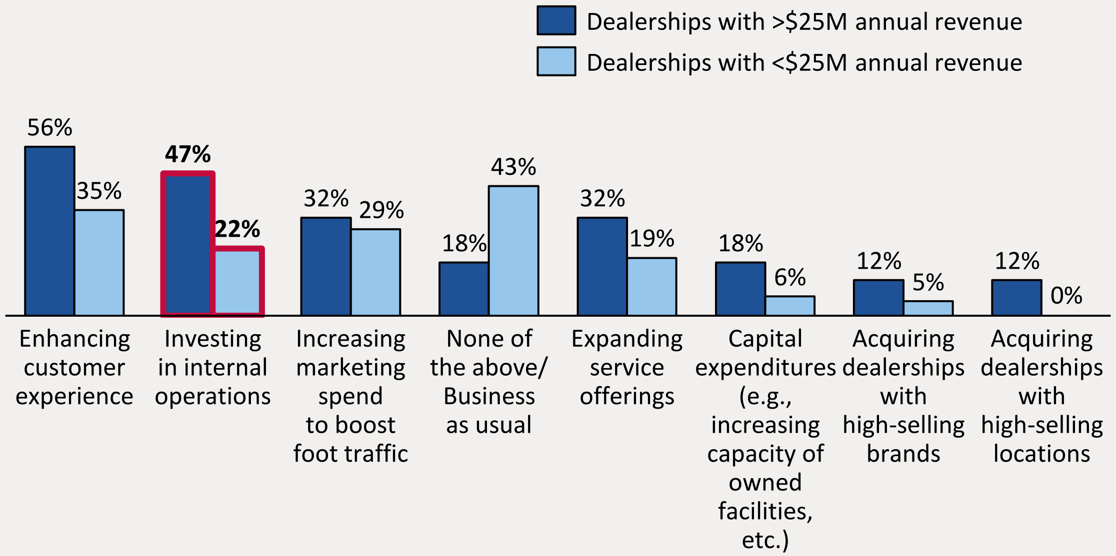
Profitability Growth Measures

Q: Which of the following strategies will your dealership(s) employ to improve or maintain profitability in the coming year? (select all that apply)



Revenue Growth Measures

Q: Which of the following strategies will your dealership(s) employ to drive revenue growth in the coming year? (select all that apply)



- **Internal operational improvements are the focus for ambitious dealers:** inventory management, investment in tech (DMS, sales tech) are top of mind, more so than marketing spend
- The importance of investment in robust tech is proving to be especially critical: June's CDK cyber-attack (in which 15k dealerships were significantly affected & most deals halted) demonstrated how reliant dealerships are on strong tech partners

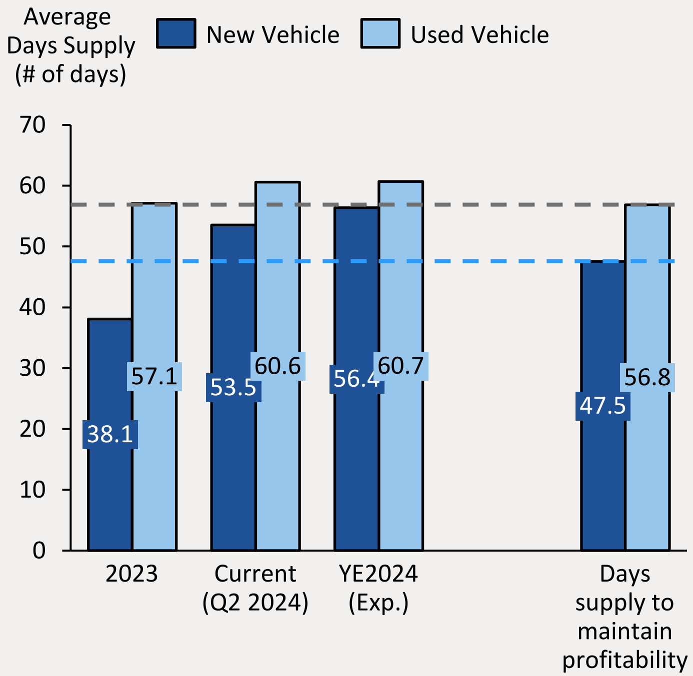
Source: Kaiser Associates Q2 2024 Dealership Survey

Inventory Management: Combination of high rates and slowing consumer demand is driving up inventory levels, and dealership financing towards floorplan expenses

Dealership Inventory Management Trends

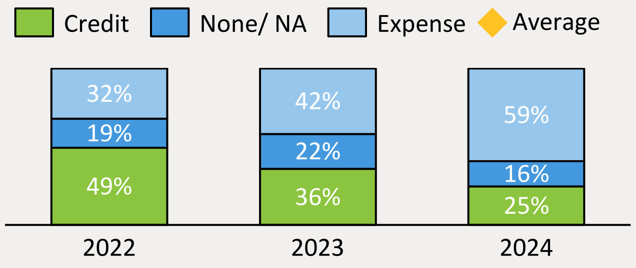
Q: What are your days' supply at your dealership(s) in 2023/ Q2 2024, and expectations for YE 2024?
Q: What days' supply does your dealership(s) need to comfortably maintain profitability?

Days Supply Trends & Sentiment Tracker



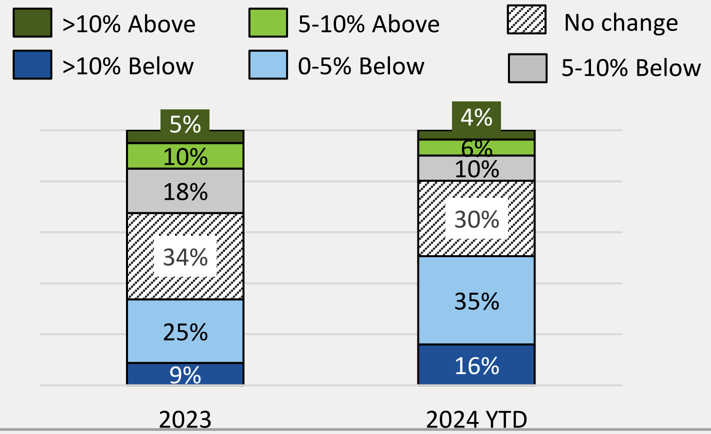
Q: What was your floorplan credit / expense PVR in 2022, 2023, and 2024?

Floor Plan Credit / Expense Ratios



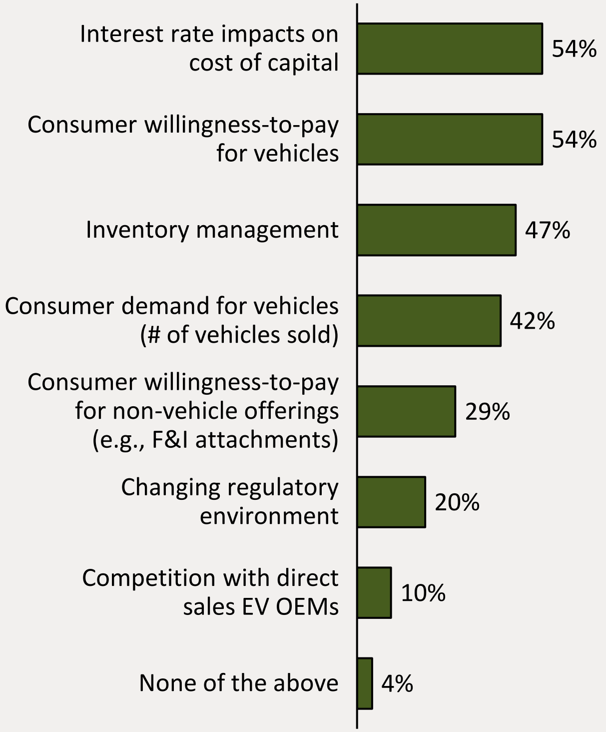
New Vehicle Sales Price Trends

Q: Including incentives, how much are you selling new vehicles relative to MSRP this year vs last year?



Dealership Operation Concerns

Q: Which dealership-specific factors do you believe will pose a significant challenge to your dealership(s) profitability in 2024? (select all that apply)



Source: Kaiser Associates Q2 2024 Dealership Survey

M&A Trends and Forecast: The M&A landscape has been active and buyer/seller interest remains strong, but valuation expectations are still up in the air

Start of Year Perspective	What's Happened Since?	DCG's Retail Automotive Takeaways
1 **M&A activity to remain elevated vs pre-COVID levels**	• ***Strong M&A volume to date:*** Q1 2024 M&A volume (37 deals involving 159 dealerships) was one of the highest on record (and on track to beat 2023 annual volume); Q2 saw a decline in # of stores sold but remained steady in # of deals completed.	• **We're going to continue to see a very active dealer M&A environment** driven by three simple factors: • Dealers are 1) working harder to 2) make less money and half of them don't have the incentive to hold on to the asset long-term because 3) they have no succession plan.
2 **Dealership profitability remains elevated above pre-pandemic levels**	• ***Forward-looking interest is healthy (and balanced):*** over a third (~37%) of owners are looking at buying in 2024; just under half (~44%) indicate willingness to sell in 2024, split equally between "opportunistic" sellers (would sell above asking valuation) and committed sellers (would sell at any "reasonable" valuation).	• **The automotive dealer industry is officially a buyer's market,** except for some very specific manufacturers and geographies. • **Valuations are down**, not because of blue sky multiples, but because the industry is benchmarking 2023 and validating 2023 with 2024 year-to-date. Bye-bye 2021 and 2022 profits when calculating valuation.
3 **Diversification into adjacent vehicle types is picking up**	• ***Top line growth goals (not diversification) are driving M&A:*** dealers looking to acquire in 2024 cite revenue growth as the most common driver (56% of buyers) at a far higher rate than diversifying brand portfolio (~39%), expanding geographic footprint (~33%) or achieving operational synergies (~39%).	• **In short: Covid-driven profits are dead.** Buyers are sitting on a lot of cash, but unlike the past several years, they are being patient, strategic and far more disciplined about what they're buying and what they're willing to pay.
4 **Franchise valuation multiples should remain stable**	• ***Valuation trends evolving:*** negotiations are weighting 2023 performance and 2024 YTD performance most heavily in determining transaction valuations.	• **We're seeing a very direct correlation between manufacturer performance and acquisition demand.**

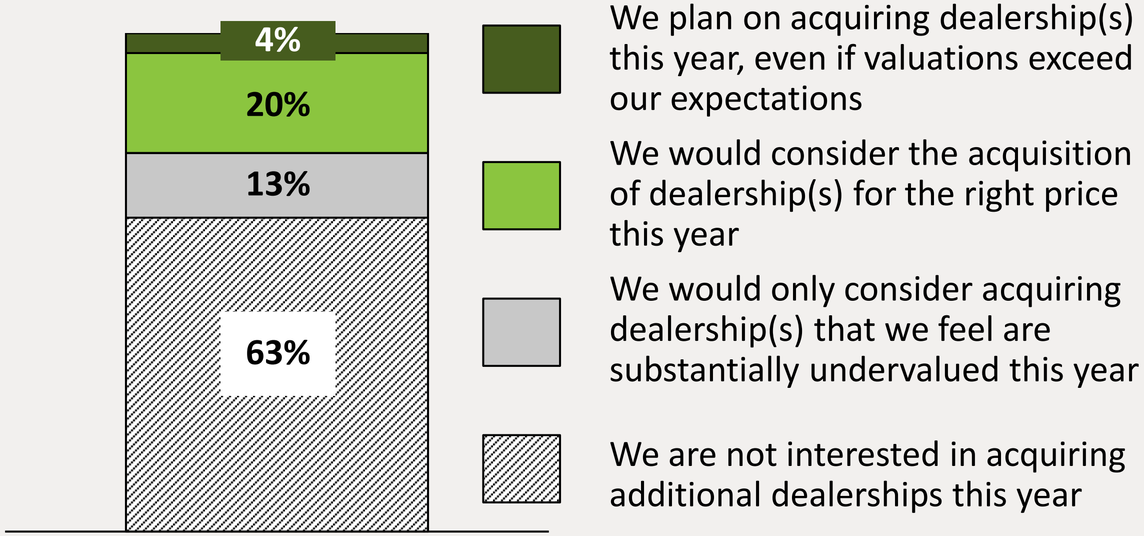
Source: Kaiser Primary and Secondary Research & Analysis; DCG Data insights / JIQ
[1] See appendix for Expected Impact Definitions

M&A Appetite: Buy/Sell appetite is fairly balanced; acquirers are looking at acquisitions to grow revenue while succession challenges are bringing prospects to market

Dealership Sentiment

Acquiring

Q: Which of the following statements best describes your / your dealership's perspective towards acquiring dealership(s) in 2024?



Dealerships gravitate towards acquisition targets that can **boost topline revenue by 10-15%**

Selling

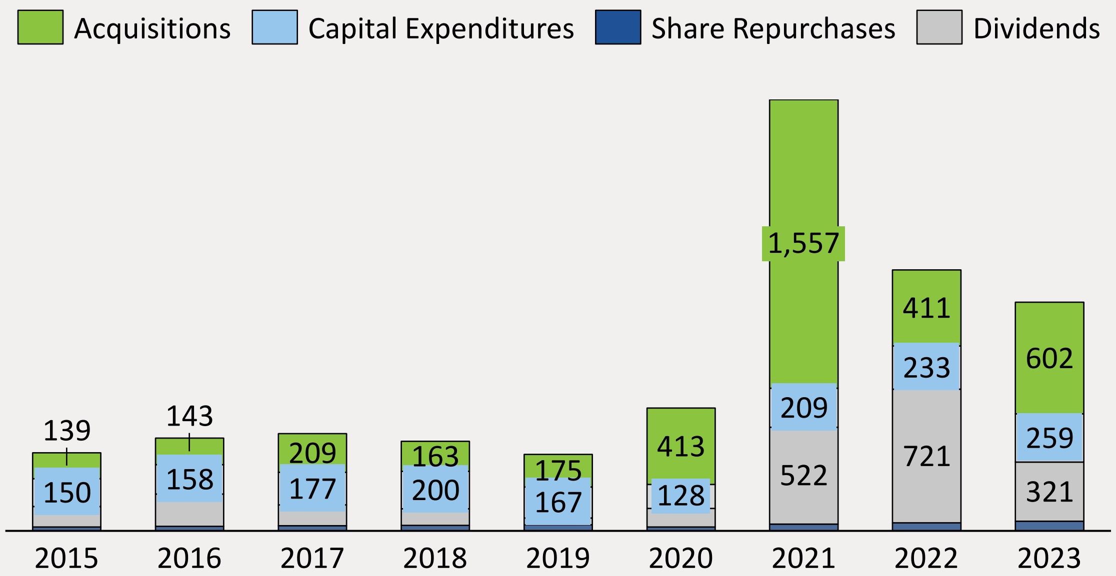
Q: Which of the following statements best describes your perspective towards selling your dealership(s) in 2024?

50% of dealerships who have "real" interest to sell note **lack of internal succession** as primary reason for their interest

Source: Kaiser Associates Q2 2024 Dealership Survey

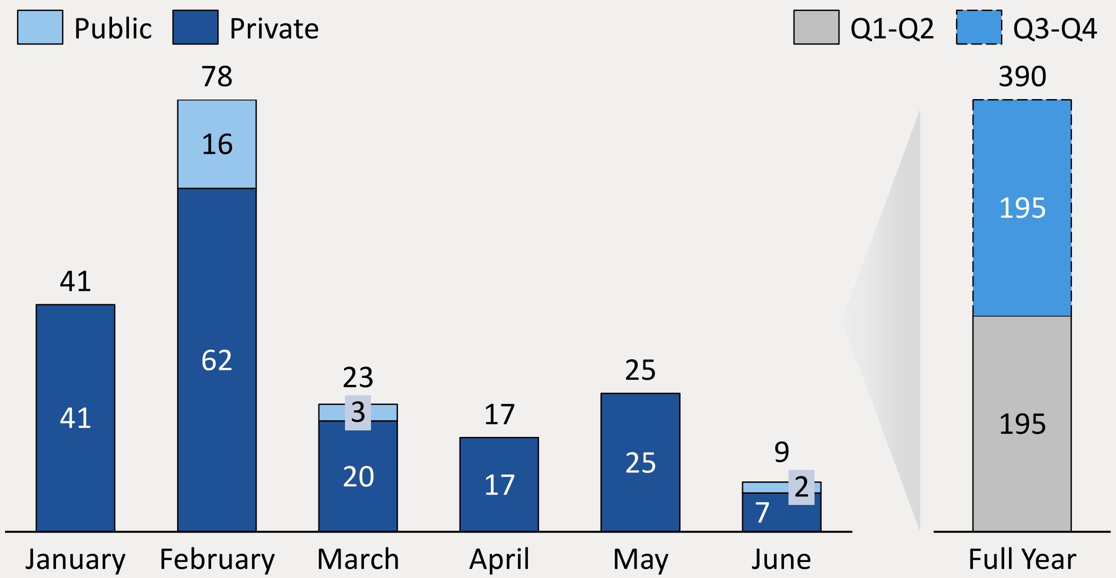
M&A Activity: Despite some concerns about how to assess dealership valuations in current climate, public dealers remain generally optimistic about opportunities for M&A in 2024

Publicly Traded Capital Allocation by Category, ($mn), 2015-2023[1]



GROUP 1 AUTOMOTIVE	*"We believe the **dealership business is the best use of capital**…we expect to **aggressively pursue M&A opportunities** that are accretive to our business"*
PENSKE	*"**We've got plenty of firepower** to make a big move or small moves"*
ASBURY AUTOMOTIVE GROUP	*"If we see [an attractive acquisition], **we wouldn't be afraid to spend money**"*
AutoNation	*"TTM is going to reflect the reality of the fact that **there's a normalization in margins…it will impact values**"*
LITHIA	*"We will continue to assess valuation trends and **balance our M&A expectations**"*
Sonic Automotive	*"We remain **focused on returning capital to shareholders via share repurchases**"*

2024 Franchises Acquired to Date



- The first half of 2024 has seen a small number of acquisitions involving **large numbers of franchises** (e.g., Holman's purchase of 25 stores from Leith Automotive). While the volume of stores sold dropped in Q2 vs Q1, transaction volume remained steady.
- Of the 6 public groups, **only Group 1 and Lithia** completed multiple transactions (Sonic, Autonation, and Penske Automotive have yet to complete a deal in the US in 2024).

Source: Kaiser Primary and Secondary Research & Analysis; DCG Data insights / JIQ, SEC Filings, Auto News Buy/Sell Data

M&A Sentiment

Bearish *Bullish*

OEMs and Supply Chain: While new car prices have hit a plateau, new car supply is growing as production climbs; supply chains have held up well in an unpredictable year

Start of Year Perspective	What's Happened Since?	DCG's Retail Automotive Takeaways

1 **Production and inventory levels gradually stabilizing**
 2 **OEMs are re-evaluating their production plans**
 3 **Profitability expected to decline from record-highs**
 4 **Post-pandemic supply chain shifts continue**
	• ***Supply chain has dodged bullets:*** the first half of the year had potential for significant disruption, but supply chains held up well:
	   • *Houthi activity in the Red Sea* resulted in relatively minor impacts to production; lost production estimated at only ~10k units total
	   • *Key Bridge collapse:* Despite Baltimore's role as the top U.S. port for auto shipments (~850k units annually), supply chains adapted in the short term by using alternative East Coast ports - and as of mid-June, the port is fully reopened
	 • ***New vehicle supply continues to trend up:*** dealers report <u>days supply is up 30-40%</u> at the end of the first half of 2024 compared with 2023 averages. Days supply is back to pre-pandemic levels and above comfortable levels for dealer profitability.
	 • ***High new vehicle prices have stabilized:*** the average listing price for new vehicles in the US at the start of June was just over \$47k – essentially flat YoY; OEM's "fewer but more expensive" strategy is working.
		• This is a classic example of where forces can't be good for everyone in the industry at the same time. **Supply chains running smoothly is good for OEMs, OK for consumers, and a headache for dealers.**
		 • The supply-chain challenges of the COVID years were bad news for OEMs. But the low supply and high demand drove high, easy profits for dealers. The supply-chain crunch created the greatest years of profitability in the retail sector. It was good for the retail business and bad for consumers.
		 • Now that supply chains are running smoothly and manufacturers are pumping out vehicles, dealer inventories are piling up, particularly with certain manufacturers. It's creating headaches for dealers and more competitive pricing for consumers.
		 • **Once the dust settles and the tug of war is over, we predict inventory levels will look very much like they did in 2019.**

Source: Kaiser Primary and Secondary Research & Analysis; DCG Data insights / JIQ

Politics and Regulation: While the ’24 presidential election remains top of mind, major Supreme Court rulings are likely to reduce agency (especially EPA) influence on the industry

Start of Year Perspective	What’s Happened Since?	DCG’s Retail Automotive Takeaways
1 **The impact of the CARS Rule will be felt unevenly across states** **2** **CARS Act is more political theater than actionable legislation for 2024** **3** **Landscape around EV direct sales will continue to evolve at a state level** **4** **Outcome of 2024 election will be most pronounced on EV incentives**	• ***While the election continues to dominate …*** **:** A tight presidential race became more dramatic with Biden’s exit in July, creating buzz and uncertainties about the upcoming change in leadership. • ***… Recent Supreme Court decisions may be more impactful on the industry:*** The U.S. Supreme Court’s ruling in *Loper Bright Enterprises v. Raimondo* spells an end to “Chevron deference” (which for ~40 years instructed judges to defer to agencies (such as the EPA) where there is ambiguity. • The end of Chevron deference is likely to reduce the ability of the executive branch (i.e., the President) to single-handedly change agency interpretations. • ***CDK cyberattack & FTC compliance:*** CDK confirmed that it will handle the FTCs’ “Safeguards Rule” (requiring car dealerships to notify the FTC within 30 days of a security breach that discloses the information of > 500 customers); this may signal a “new normal” as data security remains a risk.	• The upcoming election and implications of Supreme Court rulings could have huge implications on the automotive industry. **It’s possible conservative judges could roll back recent Biden administration pollution standards for vehicles.** • Such moves could start a domino effect of alternative-energy reversals, reducing federal funding for alternative energy infrastructure as well as diminishing tax credits for electric vehicles. • **If the Chevron deference decision results in such a scenario, we’re calling the big winner right now: Tesla:** Without the incentive of tax credits for EV investments, traditional automakers and other corporations will likely look to purchase carbon credits from the pure-play electric-vehicle manufacturer rather than change the way they do business.

Source: Kaiser Primary and Secondary Research & Analysis; DCG Data insights / JIQ

Consumer preferences: While consumer trends happen in years, not quarters, the start of 2024 saw a very public win for consumer support of individual car culture in the U.S.

Start of Year Perspective	What's Happened Since?	DCG's Retail Automotive Takeaways
1 **Commuting declines since COVID mostly offset by higher non-work mileage** 2 **Ridesharing is unlikely to replace vehicle ownership** 3 **Preference for light trucks and SUVs continues to increase …** 4 **… but EV growth is not growing as fast as once predicted**	• ***High-profile pushback on NYC congestion pricing:*** The governor of NY delayed New York City's long-planned congestion pricing scheme at the last minute in June based on pushback from tri-state area commuters - • ***Consumer EV adoption continues to stabilize:*** GM's second-quarter EV sales (21,930) surpassed its previous record (20,000) as the manufacturer described sales growth as "100% demand driven". While GM has reduced its full year EV production target by ~20% (to ~250k from ~300k), it expressed confidence consumer demand and battery supply chain are aligned for the year.	• How much is too much for a new car? The answer remains to be seen. Prices seem to have peaked and with interest rates poised to come down, purchase financing will become less expensive. • The question remains: will Americans stomach spending an average of over $47,000 for a new car? **We don't think so and believe this opens the market up for disruptors who are willing to deliver lower cost vehicles to the U.S. market.** • Just how powerful is the consumer? **Powerful enough to force any administration to figure out how to allow cheaper foreign vehicles into the U.S. (Yes, even a Trump administration.)**

Source: Kaiser Primary and Secondary Research & Analysis; DCG Data insights / JIQ
[1] See appendix for Expected Impact Definitions

Macroeconomics: The U.S. economy has avoided recession but rate cuts are unlikely until Q4 (if at all) – industry participants continue to "tread water" waiting on things to change

Start of Year Perspective	What's Happened Since?	DCG's Retail Automotive Takeaways

1 U.S. economy showing strong resilience
2 Tamed inflation to drive interest rate cuts, with mixed ramifications
3 Possible disruptions from geopolitical tensions
4 Dealer M&A market is set for activity
	• ***Still avoiding recession … :*** The U.S. has successfully avoided recession in the first half of the year; disinflation has continued despite small bumps in April and May.
	• ***… but persistent high rates are throwing a wrench in dealers' plans:*** Expectations for rate-cut timeline have shifted; earliest rate cuts (if any) not expected until September. In the meantime, the elevated rate environment continues to complicate dealership strategy/planning.
	  • High rates are the top barrier to maintaining 2023-level profitability (cited as top reason by 77% of dealership owners).
	  • Rates are affecting M&A appetite (dealers with cash on hand and/or lower debt service are more likely to acquire; dealers facing pending refinancing may be looking to sell).
	  • Marketing budgets remain historically low as dealers anticipate needing cash for financing.
		• **It's all about interest rates right now,** and not just as a driver of consumer demand.
		• Higher interest rates have driven up dealership costs, on carrying inventory, real estate loans and other operational expenses, and these are eating into already thinning margins.
		• That makes Fed meeting dates on July 31, September 18, November 7 and December 18 four of the most important dates for the automotive industry to pay attention to.
		• **We expect the Fed to surprise with three interest-rate cuts before year's end.**

Source: Kaiser Primary and Secondary Research & Analysis; DCG Data insights / JIQ
[1] University of Michigan Survey of Consumers
[2] Bureau of Labor Statistics
[3] See appendix for Expected Impact Definitions

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