CONTRARIAN RESEARCH REPORT

The Contrarian Series

March 18, 2022

AutoNation Inc.

(Buy)

Price (intraday):	$117.02	**Ticker:**	AN
52-Week Range:	$85.15 - $133.48	**Dividend:**	n/a
Shares Outstanding:	61.4 million	**Yield:**	n/a
Market Capitalization:	$7.18 billion		

Data as of March 18, 2022

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Investment Thesis

AutoNation, Inc. is the largest automotive retailer in the U.S., with almost 250 locations and revenues exceeding $20 billion annually. The company sells a full spectrum of vehicles, from domestic makes, such as Chevrolet and Ford, to imports (Honda, Nissan Toyota, etc.), and premium luxury brands (e.g., Audi, BMW, Mercedes-Benz and Porsche, among others). In total, it offers vehicles from 33 manufacturers. The shares were originally recommended for purchase in August 2007 (at $19), and then in April 2010 ($20) and November 2014 ($58). One element of the original investment thesis was the company's strategic share repurchase program: with a low valuation and substantial free cash flow, it had already repurchased half its shares between 2000 and early 2010. Another element of the company's growth potential was the very long "runway" for continued consolidation within the auto dealer industry: in 2010, AutoNation was the largest U.S. dealership, yet had only a 2% market share among the-then 17,000-plus dealerships. Although the number of franchises AutoNation owns has increased by 81, or 31%, over the course of decade, it still maintains a 2% franchise share.

This recommendation takes place after two years of hardship experienced by the automotive industry, as the COVID-19 pandemic caused a disruption in vehicle manufacturing, which severely restricted the number of new vehicles that could be produced. As a result, AutoNation experienced a sharp decline in its sales volume. In 2021, it sold about 20,000 fewer new vehicles than it did in 2019. However, this was offset by higher prices received for every vehicle sold, as demand remained high. This supply/demand imbalance also occurred in the used vehicle market, as consumers sought alternatives to new vehicle purchases. As a consequence, AutoNation experienced strong revenue growth and higher profit margins, enabling it to produce record earnings.

In the recently completed fiscal year, AutoNation's revenues increased by over 26%, while net income advanced by over 317%. In fact, its financial results have improved every quarter since the pandemic began, with the fourth quarter of 2021 being an all-time company record. And although its shares have responded positively to the news, appreciating by more than 350% from the pandemic low, the company still only trades at a p/e multiple of 6.3x trailing earnings.

Since AutoNation has traded at a 13.5x p/e multiple, on average, over the past decade, the shares would appear to be severely undervalued. Alternatively, the below-average valuation could imply that the investment community regards the recent earnings level to be unsustainable.

However, the circumstance leading to the exceptional earnings, the supply shortage, is ongoing. Moreover, AutoNation's management has recently vowed to continue to maintain the pricing discipline developed during the pandemic; that is, post-pandemic, they will eschew giving price discounts, so as to maintain its current profit margins.

If successful, then AutoNation should eventually receive a more appropriate valuation. Should it achieve its historical median of 13.5x earnings, then its shares would be fairly valued at $274 per share, implying capital appreciation of approximately 134%. Even at more conservative valuations, the potential return could still be exceptional. For example, should the shares trade at only 10x earnings, it would result in a return of 73%.

Meanwhile, the company will continue to pursue acquisitions as another vector for growth, since the automotive dealer industry is highly fragmented. Additionally, AutoNation will carry on its long-standing policy of repurchasing shares. Since 2000, it has retired over 81% of its shares outstanding. This alone could advance per share earnings by almost 8% per year.

AutoNation is favorably positioned to expand its net income meaningfully, but is not valued as such. Attaining a valuation in line with its historical average would result in a considerable return. As a result of the favorable risk/reward profile, purchase of AutoNation is recommended.

Company Description

History
Prior to its transformation into a vehicle retail franchise, AutoNation was one of the largest solid waste removal companies, then doing business as Republic Industries. Throughout the early- and mid-1990s, Republic acquired a number of waste removal companies. Also, during this time, Republic began to acquire companies engaged in security and alarm systems. As there was no clear benefit that could be realized from owning these two types of businesses, the company was treated as a disparate collection of assets by the investment community.

To further diversify its operations, in 1996 Republic acquired a chain of automobile rental companies that ultimately came to be known as Alamo-Rent-A-Car and National Car Rental System. The following year, certain local auto dealership franchises were added to the portfolio. By this time, despite several years of profit growth, the Republic shares routinely traded at a discount to their underlying net asset value.

In 1996, the prominent businessman Wayne Huizenga acquired Republic. Mr. Huizenga was previously successful in building the Waste Management and Blockbuster Video franchises. Clearly dissatisfied with the company's equity valuation, a disaggregation of the asset portfolio followed shortly thereafter. During 1999, the waste removal business was partially carved out into the publicly traded entity known as Republic Services, with the remaining shares sold some months later (Republic Services remains publicly traded today). In addition, the Alamo and National Rental assets were spun off, and the remainder of the company, which consisted of a small auto dealership franchise, was renamed AutoNation. Thereafter, Mr. Huizenga proceeded to pursue the acquisition of various dealer franchises much in the same manner in which he built Waste Management and Blockbuster Video.

In 2000, noted investor Eddie Lampert disclosed a seven percent stake in AutoNation. Three years prior, in 1997, Mr. Lampert had invested in the struggling auto parts retailer AutoZone; soon thereafter, AutoZone implemented a strategy of cutting costs, squeezing suppliers, and aggressively buying back shares. Under his influence, AutoNation embarked on a similar strategy and, in 2002, Mr. Lampert was named to the company's board. By mid-2003, Mr. Lampert's investments in AutoZone and AutoNation had appreciated roughly 200% and 80%, respectively. Since that time, Mr. Lambert has reduced his ownership in AutoNation from a high of approximately 55% to approximately 15% currently.

However, the largest investor in the company, currently, is Bill Gates, through his investment vehicle Cascade Investment, LLC (16.1%). Cascade has been a top holder of AutoNation since 2009.

Business Description
AutoNation is the largest automotive retailer in the U.S., owning and operating 339 new vehicle franchises from 247 store locations as of December 31, 2021. These dealerships are located predominantly in the Sunbelt region of the U.S., which includes states such as California, Florida, Texas, and Arizona.

Exhibit 1: AutoNation Franchises by State (as of 12/31/21)

State	Number of Retail Stores (1)	Number of Franchises	Number of Other Locations (2)	% of Total Revenue
Florida	49	59	20	25
Texas	44	62	18	21
California	37	49	4	19
Arizona	16	18	4	6
Colorado	15	22	1	6
Washington	14	19	3	5
Georgia	16	25	4	4
Nevada	12	13	1	4
Illinois	7	8	1	2
Tennessee	8	12	1	2
Maryland	15	17	3	1
New York	4	6	—	1
Ohio	4	4	3	1
Virginia	2	2	—	1
Alabama	3	6	—	1
Minnesota	1	1	—	1
South Carolina (3)	9	16	1	—
Total	256	339	64	100

(1) Includes franchised dealerships and AutoNation USA used vehicle stores.
(2) Includes collision centers, automotive auction operations, and parts distribution centers.
(3) Comprised of stores that were acquired at the end of the third quarter of 2021.

Source: Company reports

AutoNation often clusters dealerships within markets, allowing them to share inventory, cross-sell to customers, and reduce marketing costs. Historically, the company attempted to develop brand loyalty by uniting its dealerships under a dozen or so brand names, including AutoWay dealerships in Tampa, Florida, and Champion in southern Texas. However, in 2013, it transitioned to a unified AutoNation retail brand with the intent of increasing brand loyalty and, importantly, driving more traffic to its website.

For reporting purposes, AutoNation has three operating segments: Domestic, Import, and Premium Luxury. These segments are comprised of retail automotive franchises that sell the following 33 new vehicle brands.

Exhibit 2: AutoNation Operating Segments

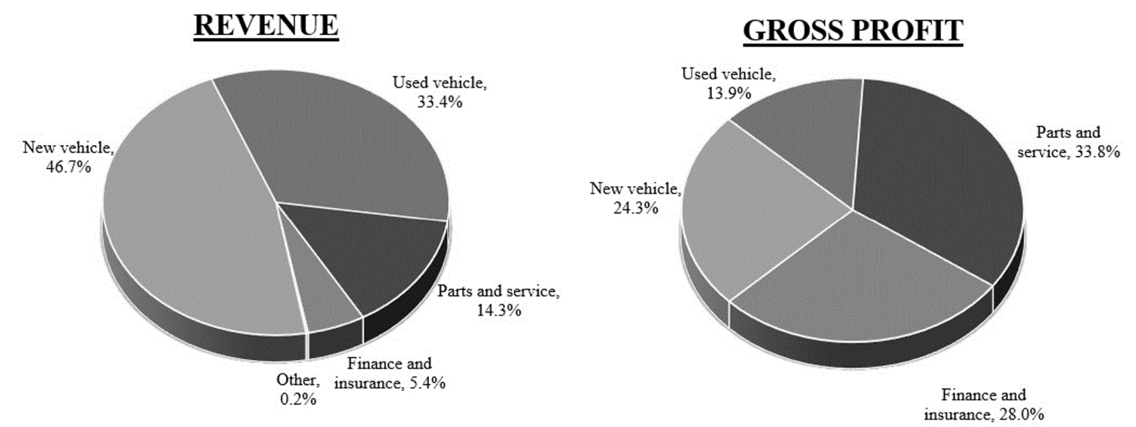
Domestic		Import		Premium Luxury	
Buick	Ford	Acura	Nissan	Alfa Romeo	Lexus
Cadillac	GMC	Fiat	Subaru	Audi	Maserati
Chevrolet	Jeep	Genesis	Toyota	Bentley	Mercedes-Benz
Chrysler	Lincoln	Honda	Volkswagen	BMW	MINI
Dodge	Ram	Hyundai	Volvo	Jaguar	Porsche
		Infiniti		Land Rover	Sprinter

Source: Company reports

In 2021, Domestic, Import and Premium Luxury represented 29.8%, 32.8%, and 37.3% of total new vehicle revenue, respectively.

Although these are AutoNation's official operating segments, the company is perhaps better understood when viewed according to its four primary sources of revenue: 1) the sale of new vehicles; 2) the sale of used vehicles; 3) auto parts and repair services; and 4) finance and insurance. Although the sale of new and used cars accounts for 46.7% of annual revenue, it only contributes to 24.3% of gross profits. Its most profitable segments, parts and service, and finance and insurance, actually comprise the majority of profit.

Exhibit 3: AutoNation Segment Contribution



Source: Company reports

Auto retailers are commonly referred to as captive dealers of the major automobile manufacturers simply because a dealer may only sell the brand of new vehicles with which it is provided. It is a heavily regulated business, as certain geographic and price limitations are imposed by state and local authoritative bodies. The auto manufacturers also exert great influence over a dealer, such as the number of dealerships that may be placed in a certain geographic area, which is an effort to maximize sales volume without allowing a sole dealership to dominate a location such that cost pressure may be exerted upon the manufacturer.

However, in order for a manufacturer to maintain a sustainable business model, the dealership must be allowed to earn a profit. Accordingly, the manufacturer will provide what is known as floor plan assistance financing. The retailer will obtain financing from the manufacturer's finance subsidiary, such as GMAC or Ford Motor Credit, to purchase its inventory. The finance subsidiary will in turn refund a large percentage of the interest expense back to the retailer. There also exist certain advertising costs that are shared between the two entities.

Although the proportion of sales between new and used vehicles varies across dealerships, new vehicle sales generally comprise the majority of revenues. However, this is the least profitable undertaking of an auto retailer. The manufacturer provides inventory at roughly the same cost to most dealer organizations, and parity exists in the context of retail price, since one dealer may not dominate an entire geographic area. The gross margin of new auto sales tends to be at the six percent level. A slightly higher profit may be realized from the sale of a used vehicle. For reasons that may be obvious to readers, the trade-in or wholesale price at which the vehicle is purchased differs dramatically from the ultimate resale price. Nonetheless, an 8% gross margin is fairly customary.

Thus, if vehicle sales represented the only opportunity set for the dealership, it is hard to imagine that the business would generate a profit. Practically speaking, with a 6% to 8% gross margin, there would be very little remaining income to pay employees. Therefore, there must be a self-sustaining element. This is provided by vehicle repair and financing income. The former is a function of the quality of the vehicles sold and a manufacturer's given policy towards a warranty program. Product repair performed under a vehicle warranty is usually a form of reimbursement payment from the manufacturer. Outside the parameters of a warranty, vehicle repair permits a certain degree of retail markup for such services. Moreover, certain repairs may only be performed by licensed or approved dealerships. Hence, this element of earnings can be recurring in nature.

Finance-related income entails a percentage of commission that is earned from each vehicle sale. For instance, if one purchases a General Motors vehicle, the dealership will encourage this particular loan to be financed by GMAC, as opposed to an independent lending institution. The interest rate and default risk are assumed by the financing provider. Yet, the retailer will earn a commission for each loan issued. Certain warranties and insurance policies are commissioned in the same manner. Consequently, since there is no direct cost for this activity, it generates a gross margin of 100%.

The importance of vehicle repair and financing has led to the rapid growth of a relatively new product for auto dealers: certified pre-owned vehicles. These used vehicles are generally late model, low mileage units that are reconditioned and offered for sale with a manufacturer's warranty. Usually priced in between a new car and traditionally older used car, certified pre-owned vehicle programs are a boon to dealers because these units can only be sold by franchised dealers. As such, the purchase weds the customer to the dealer for the life of the extended factory warranty, thereby increasing parts sales and vehicle repair revenue. In 2000, according to the National Automobile Dealers Association, roughly 600,000 certified pre-owned vehicles were sold in the U.S. Last year, this figure increase over threefold to more than 2.5 million.

Separate from the certified pre-owned operation, the used car market is sufficiently profitable that AutoNation has embarked on establishing retail locations focused solely on this market. Towards this end, the company established AutoNation USA standalone pre-owned vehicles sales and services centers. These locations attempt to overcome the generally negative perception of used car lots by offering a firm, haggle-free price and making the purchase of a pre-owned vehicle easy. To date, the company has opened ten AutoNation USA stores and plans to open an additional twelve over the next year. Its expansion plan is fairly aggressive, targeting over 130 stores by 2026, or roughly 30 per year.

Management

It should be noted that AutoNation's long-time Chairman and CEO, Mike Jackson retired in November 2021. Mr. Jackson served as CEO and as a director of the board since September 1999. Previously, he served as President and CEO of Mercedes-Benz USA, and from 1979 to 1990 he was an auto dealer, operating as managing partner of Euro Motorcars in Bethesda.

Mr. Jackson was replaced by Mike Manley as CEO and member of the board in 2021. Mr. Manley served as Head of Americas for Stellantis, the auto manufacturer that was created by the merger of Fiat Chrysler Automobiles and the French PSA Group in early 2021. He was previously the CEO of Fiat Chrysler Automobiles from July 2018 to January 2021, when the merger was consummated. Prior to that, he served in a variety of roles at DaimlerChrysler.

Financial Review

For obvious reasons, it is difficult at the current time to avoid examining the financial results of companies without taking into consideration the effects of the COVID-19 pandemic that has lasted for the past two years. In the case of the automotive industry, it is especially pertinent, as there has been a severe shortage of new cars available for sale due to the initial pandemic lockdowns (which caused production to temporarily cease), as well as subsequent issues with semiconductor chip availability. Since modern vehicles are designed with substantial electronic componentry for safety and performance features (e.g., stability control, antilock braking, drive-by-wire, etc.), it is impossible to manufacture them without these critical devices.

Although this circumstance of lower volume would normally be interpreted as a negative for the auto retailers, demand for vehicles, both new and used, did not decline, and the imbalance was corrected by way of higher selling prices.

For this reason, AutoNation reported record earnings in 2021, even though the number of new cars sold declined from pre-pandemic levels. For example, the company sold 262,403 new vehicles last year, as compared to 282,602 in 2019. Yet, new vehicle revenues increased from $11.16 billion to $12.08 billion. However, its focus on used vehicles, with 304,364 used vehicles sold in 2021, versus 246,113 in 2019 and 241,182 in 2020, contributed to an overall volume gain,.

Exhibit 4: AutoNation Vehicle Unit Sales (2019-2021)

	2019	2020	2021
New vehicle	282,602	249,654	262,403
Used vehicle	246,113	241,182	304,364
	528,715	490,836	566,767

Source: Company reports

For the year, total revenues increased to $25.84 billion from $21.33 billion in 2019 and $20.39 billion in 2020. At the same time, its gross profit margin increased to 19.16%, from the prior year's 17.49%. As a result, net income totaled $1.37 billion in 2021, representing an increase of 259% and 205% from 2020 and 2019, respectively.

Exhibit 5: AutoNation Summary Income Statement (2019-2021)

	2019	2020	2021
New vehicle	$ 11,166.5	$ 10,418.6	$ 12,081.7
Used vehicle	5,466.5	5,601.3	8,638.8
Parts & service	3,572.1	3,257.4	3,706.6
Finance & insurance	1,023.3	1,059.3	1,384.5
Other	107.3	53.4	32.4
	21,335.7	20,390.0	25,844.0
Cost of Sales	17,812.7	16,823.6	20,891.4
Gross Profit	3,523.0	3,566.4	4,952.6
Selling, general & admin.	2,558.6	2,422.0	2,876.2
Depreciation & amortization	180.5	198.9	193.3
Goodwill impairment	-	318.3	-
Other expenses/(income)	(39.7)	64.0	(19.7)
	823.6	563.2	1,902.8
Non-operating expense	211.0	13.1	94.4
Pre-tax income	612.6	550.1	1,808.4
Taxes	161.8	168.3	435.1
Loss from discontinued ops.	0.8	0.2	0.3
Net income	$ 450.0	$ 381.6	$ 1,373.0
EPS	$ 4.99	$ 4.32	$ 18.50

($ in millions)

Source: Company reports

Granted, the extraordinary year-over-year increase was assisted, in part, by impairment charges in the prior year that did not occur in 2021. However, the supply/demand imbalance did impose a stricter pricing discipline that reduced or eliminated the traditional practice of price negotiation, or "haggling," that normally occurs with a car purchase. As a result, AutoNation was able to sell its vehicles at the manufacturer's suggested retail price ("MSRP"). This led to an almost doubling of the average gross profit per new vehicle. In fact, the gross profit increased in every segment, to some degree.

Exhibit 6: AutoNation Average Gross Profit per Vehicle (2019-2021)

				% change	
	2019	2020	2021	*2019-2020*	*2020-2021*
New vehicle	$ 1,783	$ 2,340	$ 4,579	*31.2%*	*95.7%*
Used vehicle	1,409	1,719	2,045	*22.0%*	*19.0%*
Finance & insurance	1,935	2,158	2,443	*11.5%*	*13.2%*

Source: Company reports

The increase in gross profits and margins, combined with a lesser increase in selling, general and administrative expenses (by far its single largest operating cost), led to the large net income advancement.

Balance Sheet

As previously discussed, auto manufacturers provide dealers with floor plan assistance financing. Dealers obtain financing from the manufacturer's finance subsidiary, such as GMAC or Ford Motor Credit, to purchase its inventory, while the finance subsidiary, in turn, refunds a large percentage of the interest expense back to the dealer. At year-end 2021, AutoNation's vehicle floor plan payable totaled $1.45 billion. This is a notable decline from the prior year's balance of $2.75 billion, care of the automobile shortage, which was manifest in much lower dealer inventory, otherwise known as "cars on the showroom floor."

Additionally, the company has outstanding $340 million of commercial paper. This program is utilized as short-term financing for a variety of uses, including repaying borrowings under its revolving credit facility, financing acquisitions and working capital, capital expenditures, share repurchase, and other corporate purposes.

As to long-term debt, AutoNation has $2.88 billion outstanding, of which the earliest maturity is due in November 2024.

Exhibit 7: AutoNation Schedule of Long-Term Debt (2020-2021)

Debt Description	Maturity Date	Interest Payable	2020	2021
3.35% Senior Notes	15-Jan-21	January 15 and July 15	$ 300.0	$ —
3.5% Senior Notes	15-Nov-24	May 15 and November	450.0	450.0
4.5% Senior Notes	1-Oct-25	April 1 and October 1	450.0	450.0
3.8% Senior Notes	15-Nov-27	May 15 and November	300.0	300.0
1.95% Senior Notes	1-Aug-28	February 1 and August 1	—	400
4.75% Senior Notes	1-Jun-30	June 1 and December 1	500.0	500.0
2.4% Senior Notes	1-Aug-31	February 1 and August 1	—	450
Revolving credit facility	26-Mar-25	Monthly	—	—
Finance leases and other debt	Various dates through 2041		116.6	330.6
			2,116.60	2,880.60
Less: unamortized debt discounts and debt issuance costs			-14.8	-22.2
Less: current maturities			-309.2	-12.2
Long-term debt, net of current maturities			$ 1,792.60	$ 2,846.20

($ in millions)

Source: Company reports

In total, at year end, AutoNation had $3.19 billion of debt outstanding (not including the floor plan financing). With shareholders' equity of $2.37 billion and total assets of $8.94 billion, the company has a debt-to-equity ratio of 1.34x and a debt-to-assets ratio of 0.35x. Although its debt has increased on a year-over-year basis, its interest coverage ratio of 16.0x is still excellent (in 2020, the interest coverage ratio was 5.9x, excluding the impairment charges).

In terms of liquidity, AutoNation has approximately $60.4 million of cash on the balance sheet, as well as $1.4 billion of availability from its credit facilities. The company has a leverage ratio of 1.48x and a capitalization ratio of 52.7%, which is well below the maximum requirements of 3.75x and 70.0%, respectively, imposed by the financial covenants of its debt agreements. Therefore, the company has the capacity to further increase its debt load, should it choose so for opportunities, such as acquisitions, that may arise in the coming years.

Valuation

At the onset of the COVID-19 pandemic, AutoNation's share price dropped sharply in sympathy with the overall equity markets due to the uncertainties that arose at the time. However, since reaching a low of approximately $24 per share in April 2020, the price has increased significantly, reaching a peak of $130 in October 2021, before settling to its current price of roughly $117. From the trough, the shares have appreciated by over 375%. Yet, even at this higher level, the shares trade at only 6.3x 2021 earnings. This is about the lowest multiple recorded by the company over the past ten years.

This is an extraordinarily low valuation, especially when viewed in comparison to the S&P 500's of approximately 22x trailing earnings, and suggests that the equity market considers

AutoNation's recent earnings as "windfall" profits that cannot be repeated. While this is true to some extent, it should not be forgotten that the vehicle shortage is ongoing and therefore the opportunity to produce similar results this year exists.

Moreover, it ignores the proclamation by CEO Mike Manley, that the lessons of the pandemic have encouraged AutoNation to cease discounting new vehicles. In other words, the crisis has imposed newfound discipline among the auto manufacturers and retailers to reduce, or even eliminate, the amount of significant discounting and high incentives that was prevalent in the industry prior to the pandemic. If that is the case, then the improved gross margins could persist.

The analyst community appears to agree, in part, as the company is forecasted to produce higher revenues[1]: $27.6 billion in 2022 and $28.6 billion in 2023 (vs. $25.8 billion in 2021). Although forecasts for the subsequent years can be susceptible to much more variation (i.e., uncertainty), at the moment, the company is expected to produce $29.8 billion and $37.9 billion of revenues in 2024 and 2025, respectively.

GAAP earnings per share is expected to increase slightly from $18.50 last year to $20.29 this year, followed by a decline to $18.88 in 2023. Thus, AutoNation is valued at 5.7x 2022 and 6.1x 2023 estimated earnings.

If it can be accepted that these earnings estimates represent AutoNation's normalized level of income going forward, then at some point, it should cease to trade at a punitive multiple. Were the company to achieve the median price/earnings multiple established over the past decade, then its 2022E earnings would be capitalized at 13.5x, resulting in a price of $274 per share, suggesting appreciation potential of 134% from the current level. Notably, if one were to exercise caution and conservatively apply a lower multiple of, say 10x, it would still result in a share price of $202, which exceeds the current price by roughly 73%. In this case, one could reasonably agree that the AutoNation shares are undervalued; it is just the degree of undervaluation that is subject to debate.

[1] Source: Bloomberg

Exhibit 8: AutoNation Range of P/E Multiples and Associated Share Prices

P/E Multiple	Share Price	% Change
8x	$162.38	38.8%
9x	$182.68	56.1%
10x	$202.98	73.5%
11x	$223.28	90.8%
12x	$243.58	108.1%
13x	$263.87	125.5%
13.5x	$274.02	134.2%
14x	$284.17	142.8%
15x	$304.47	160.2%
16x	$324.77	177.5%
17x	$345.07	194.9%

Note that the below-market valuation is not limited to AutoNation. Its peers, also having appreciated greatly since early-2020 and similarly trade at mid-single digit price/earnings multiples. Thus, although AutoNation is not undervalued on a comparative basis to its competitors, it is possible that the entire industry as a whole is undervalued.

Exhibit 9: AutoNation Peer Group Valuation

	Penske Automotive	Group 1 Automotive	Asbury Automotive	Sonic Automotive
Ticker	PAG	GPI	ABG	SAH
Share Price	$ 103.03	$ 193.27	$ 187.02	$ 47.16
Market cap. (mills.)	$ 7,966	$ 3,293	$ 4,336	$ 1,896
Forward P/E	6.9x	5.1x	5.6x	4.7x

Source: Bloomberg

Aside from the valuation re-rating, one should consider AutoNation's propensity for reducing its share count as a value-enhancing strategy. Since Eddie Lampert took a stake in the company in 2000, the share count has been systematically reduced by a cumulative 81%, or 7.8% annually. Further reductions in the outstanding shares will, of course, impact the earnings per share growth over the next few years. All else equal, were the company to continue repurchasing shares at the same rate as its historical average, its per share earnings could advance by almost 8% per year, even absent any improvement in net income. This would lead to a similar increase in the share price, all else equal.

Exhibit 10: AutoNation Historical Shares Outstanding (2000-2021)

Year	Shares Out.	Year	Shares Out.
2000	337.1	2012	121.0
2001	321.5	2013	119.1
2002	289.9	2014	113.6
2003	268.8	2015	107.2
2004	265.7	2016	100.9
2005	262.5	2017	91.8
2006	209.1	2018	90.1
2007	180.0	2019	89.5
2008	176.9	2020	82.2
2009	170.5	2021	61.7
2010	149.1	Cumulative:	-81.7%
2011	131.9	Annualized:	-7.8%

(Shares in millions)

Source: Company reports

In the year 2021 alone, the share count was reduced by almost 25%, as the company utilized the large cash flow to fund share repurchases. At present, there is $776 million of authorized share repurchases remaining, which would translate into a further 10% reduction in shares outstanding at the current stock price.

Additionally, besides the pent-up demand for new vehicles, AutoNation has the opportunity to grow through acquisitions. Although the company is the largest automotive retailer, it only holds only a 2.0% market share of the 16,658 new-car dealerships in operation in the U.S., of which the vast majority are privately-owned. The industry is highly fragmented, offering consolidators with capability to acquire smaller competitors in the coming years.

For example, in 2021 alone, AutoNation acquired two dealerships, Peacock Automotive Group and Priority 1 Automotive, that added 20 dealerships (11 and nine additional dealerships, respectively) to its total. As such, there are multiple pathways to revenue growth available to the company.

Summary and Recommendation

AutoNation is the country's largest automotive retailer. Since the start of the COVID-19 pandemic, the availability of new cars has collapsed, first because of the lockdowns that were designed to slow the spread, which caused a production stoppage for several months. This was followed by the supply chain crisis, as well as a shortage of semiconductor chips that are integral to the safe operation of modern vehicles.

Contrarily, demand for automobiles have not declined, such that the company found itself in the enviable position of dictating the sales price of the new cars that it did have available; in other words, no discounts were given to prospective buyers. As a consequence, AutoNation was able to increase revenues despite lower sales volume, leading to a significant increase in margins and, ultimately, earnings. Consequently, even though its stock has increased over three-fold over the past two years, it still trades at a low earnings multiple of just 6.3x trailing earnings.

If its newfound pricing power could be maintained—which appears to be possible given that the supply/demand imbalance is ongoing—then the company's shares should attract a much higher valuation. For example, were it to be valued at its 10-year median p/e of approximately 13.5x, the stock would trade at \$274 per share. This would imply further capital appreciation of 134% from this point. Even a more modest multiple of 10x trailing earnings would result in a return of 73%.

Additionally, AutoNation has been a prolific repurchaser of its shares for over two decades. Thus, in the absence of multiple expansion, the company could achieve a higher valuation via a separate modality. Consequently, AutoNation is recommended for purchase.

AUTONATION, INC.
CONSOLIDATED BALANCE SHEETS
As of December 31,
(In millions, except share and per share data)

	2021	2020
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$ 60.4	$ 569.6
Receivables, net	730.0	845.2
Inventory	1,847.9	2,598.5
Other current assets	173.4	139.4
Total Current Assets	2,811.7	4,152.7
PROPERTY AND EQUIPMENT, NET	3,419.5	3,138.1
OPERATING LEASE ASSETS	284.0	309.5
GOODWILL	1,235.3	1,185.0
OTHER INTANGIBLE ASSETS, NET	743.5	521.5
OTHER ASSETS	449.6	580.4
Total Assets	$ 8,943.6	$ 9,887.2
LIABILITIES AND SHAREHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Vehicle floorplan payable - trade	$ 489.9	$ 1,541.7
Vehicle floorplan payable - non-trade	967.7	1,218.2
Accounts payable	395.9	335.2
Commercial paper	340.0	—
Current maturities of long-term debt	12.2	309.2
Accrued payroll and benefits	279.9	225.8
Other current liabilities	574.2	535.8
Total Current Liabilities	3,059.8	4,165.9
LONG-TERM DEBT, NET OF CURRENT MATURITIES	2,846.2	1,792.6
NONCURRENT OPERATING LEASE LIABILITIES	260.1	286.5
DEFERRED INCOME TAXES	78.2	95.9
OTHER LIABILITIES	322.3	310.6
COMMITMENTS AND CONTINGENCIES (Note 20)		
SHAREHOLDERS' EQUITY:		
ommon stock, par value $0.01 per share; 1,500,000,000 shares authorized; 86,562,149 shares issued at December 31, 2021, and 102,562,149 shares issued at December 31, 2020, including shares held in treasury	0.8	1.0
Additional paid-in capital	3.2	53.1
Retained earnings	4,639.9	4,069.4
Treasury stock, at cost; 23,951,543 and 19,078,620 shares held, respectively	(2,266.9)	(887.8)
Total Shareholders' Equity	2,377.0	3,235.7
Total Liabilities and Shareholders' Equity	$ 8,943.6	$ 9,887.2

AUTONATION, INC.
CONSOLIDATED STATEMENTS OF INCOME
For the Years Ended December 31,
(In millions, except per share data)

	2021	2020	2019
Revenue:			
New vehicle	$ 12,081.7	$ 10,418.6	$ 11,166.5
Used vehicle	8,638.8	5,601.3	5,466.5
Parts and service	3,706.6	3,257.4	3,572.1
Finance and insurance, net	1,384.5	1,059.3	1,023.3
Other	32.4	53.4	107.3
TOTAL REVENUE	25,844.0	20,390.0	21,335.7
Cost of Sales:			
New vehicle	10,880.1	9,834.5	10,662.6
Used vehicle	7,950.7	5,142.3	5,098.5
Parts and service	2,033.9	1,796.6	1,949.5
Other	26.7	50.2	102.1
TOTAL COST OF SALES (excluding depreciation shown below)	20,891.4	16,823.6	17,812.7
Gross Profit:			
New vehicle	1,201.6	584.1	503.9
Used vehicle	688.1	459.0	368.0
Parts and service	1,672.7	1,460.8	1,622.6
Finance and insurance	1,384.5	1,059.3	1,023.3
Other	5.7	3.2	5.2
TOTAL GROSS PROFIT	4,952.6	3,566.4	3,523.0
Selling, general, and administrative expenses	2,876.2	2,422.0	2,558.6
Depreciation and amortization	193.3	198.9	180.5
Goodwill impairment	—	318.3	—
Franchise rights impairment	—	57.5	9.6
Other (income) expense, net	(19.7)	6.5	(49.3)
OPERATING INCOME	1,902.8	563.2	823.6
Non-operating income (expense) items:			
Floorplan interest expense	(25.7)	(63.8)	(138.4)
Other interest expense	(93.0)	(93.7)	(106.7)
Other income, net	24.3	144.4	34.1
INCOME FROM CONTINUING OPERATIONS BEFORE INCOME TAXES	1,808.4	550.1	612.6
Income tax provision	435.1	168.3	161.8
NET INCOME FROM CONTINUING OPERATIONS	1,373.3	381.8	450.8
Loss from discontinued operations, net of income taxes	(0.3)	(0.2)	(0.8)
NET INCOME	$ 1,373.0	$ 381.6	$ 450.0
BASIC EARNINGS (LOSS) PER SHARE:			
Continuing operations	$ 18.51	$ 4.32	$ 5.00
Discontinued operations	$ —	$ —	$ (0.01)
Net income	$ 18.50	$ 4.32	$ 4.99
Weighted average common shares outstanding	74.2	88.3	90.1
DILUTED EARNINGS (LOSS) PER SHARE:			
Continuing operations	$ 18.31	$ 4.30	$ 4.98
Discontinued operations	$ —	$ —	$ (0.01)
Net income	$ 18.31	$ 4.30	$ 4.97
Weighted average common shares outstanding	75.0	88.7	90.5
COMMON SHARES OUTSTANDING, net of treasury stock, at period end	62.6	83.5	89.3

AUTONATION, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
For the Years Ended December 31,
(In millions)

	2021	2020	2019
CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES:			
Net income	$ 1,373.0	$ 381.6	$ 450.0
Adjustments to reconcile net income to net cash provided by operating activities:			
Loss from discontinued operations	0.3	0.2	0.8
Depreciation and amortization	193.3	198.9	180.5
Amortization of debt issuance costs and accretion of debt discounts	4.9	4.7	5.2
Stock-based compensation expense	35.0	30.2	31.1
Deferred income tax provision (benefit)	(17.4)	(38.9)	45.8
Net gain on asset sales and dispositions	(18.1)	(7.9)	(44.9)
Goodwill impairment	—	318.3	—
Franchise rights impairment	—	57.5	9.6
Other non-cash impairment charges	3.2	14.7	2.2
Gain on equity investments	(10.9)	(131.5)	(25.7)
Other	(13.3)	(11.0)	(6.8)
(Increase) decrease, net of effects from business combinations and divestitures:			
Receivables	114.9	70.0	56.2
Inventory	800.4	703.6	296.0
Other assets	92.2	85.6	49.5
Increase (decrease), net of effects from business combinations and divestitures:			
Vehicle floorplan payable-trade	(1,059.7)	(579.3)	(240.6)
Accounts payable	57.2	47.7	(17.6)
Other liabilities	73.0	63.2	(22.1)
Net cash provided by continuing operations	1,628.0	1,207.6	769.2
Net cash used in discontinued operations	(0.3)	—	—
Net cash provided by operating activities	1,627.7	1,207.6	769.2
CASH PROVIDED BY (USED IN) INVESTING ACTIVITIES:			
Purchases of property and equipment	(215.7)	(156.0)	(269.3)
Proceeds from the disposal of assets held for sale	37.1	16.4	38.0
Insurance recoveries on property and equipment	2.0	1.9	3.5
Cash used in business acquisitions, net of cash acquired	(432.7)	(0.4)	(4.7)
Cash received from business divestitures, net of cash relinquished	48.7	9.0	115.6
Proceeds from the sale of equity securities	109.4	105.4	—
Investment in equity securities	(5.5)	(50.0)	—
Other	(3.6)	—	1.1
Net cash used in continuing operations	(460.3)	(73.7)	(115.8)
Net cash used in discontinued operations	—	—	—
Net cash used in investing activities	(460.3)	(73.7)	(115.8)

This report was produced by Horizon Kinetics ("HK"). The following persons employed by HK contributed to this report: Murray Stahl, Chairman, Steven Bregman, President, and Peter Doyle, Managing Director. HK is located at 470 Park Avenue South, New York, NY 10016. At the time of this report, there are no planned updates to the recommendations. To the extend HK has provided previous recommendations concerning the same issuer(s) during the preceding 12-month period, such recommendations do not differ from the recommendations contained here.

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