# CONTRARIAN RESEARCH REPORT

*The Contrarian Series*

January 10, 2020

## Penske Automotive Group, Inc.

*(BUY)*

| | | | |
|---|---|---|---|
| **Price (close):** | $47.63 | **Ticker:** | PAG |
| **52-Week Range:** | $41.26 - $53.81 | **Dividend:** | $1.58 |
| **Shares Outstanding:** | 81.1 million | **Yield:** | 3.3% |
| **Market Capitalization:** | $3.86 billion | | |

*Data as of January 9, 2020*

PCS RESEARCH SERVICES

*Exclusive Marketers of*
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PCS Research Services
100 Wall Street, 20th Floor
New York, NY 10005
research@pcsresearchservices.com
(212) 233-0100
www.pcsresearchservices.com

HORIZON KINETICS

***Research Team***

**Murray Stahl** **Steven Bregman**

Rich Begun, Thérèse Byars, Ryan Casey, James Davolos, Peter Doyle

Matthew Houk, Utako Kojima, Eric Sites, Fredrik Tjernstrom, Steven Tuen

**Investment Thesis**

Penske is the second largest retail automotive dealership company in the United States. It operates 149 dealership franchises in the U.S. and 184 internationally. Over the last decade, the company has also expanded into commercial and heavy-duty truck retail, as well as truck rental/leasing. The truck leasing business, of which Penske owns 28.9%, has performed well over the years, and now accounts for almost 30% of overall pre-tax income.

The earnings of Penske will naturally ebb and flow with the sale of new and used vehicles, which is a cyclical industry. At the moment, new vehicle sales have plateaued and most investors believe the industry will contract next year. This prospective weakness would almost certainly be accelerated by any noticeable deterioration in the overall economies of either the United States or Europe.

While this is clearly a possibility, such declines have historically been only temporary, as the natural wastage rate of vehicles compels consumers to purchase a new vehicle over time. Viewed in this light, the long-term record of Penske has been reasonably good. For instance, while the company's earnings did decline dramatically during the 2008/2009 recession, the revenue growth rate since 2007 has been 5.4% annually, while net earnings have expanded by 13.2% per annum. The modest share repurchase program of the last decade has reduced shares outstanding by roughly 14%, creating an annualized earnings per share increase of 14.3% during this time.

Nonetheless, investors anticipate a flat, or possibly declining base of earnings over the next two years. It should be noted that the Penske shares were previously recommended for purchase in December 2015 by this publication. At the time, they were priced at slightly under $44 per share. That price represented an earnings multiple of just under 11x the-then forward earnings and judged to be undervalued in light of its demonstrated earnings growth and that it traded at a discount to the broader market.

While the shares have appreciated modestly over the past four years, it would appear that the tepid performance was less of a reflection on Penske than it was the result of weakness in auto-related shares generally. For example, the First Trust NASDAQ Global Auto Index ETF (CARZ), an exchange-traded fund that tracks the performance of global automakers, actually declined, albeit slightly (i.e., less than 10%), over the same time frame.

Yet, the company's revenues have risen steadily, if modestly, and operating and net income have increased rather robustly. For whatever attributable reasons, the valuation has been contracting while the company appears to be operating consistently in all respects, and now has a base of earnings that is considerably higher than four years ago.

Currently, the shares trade at 9.1x the 2019 consensus earnings forecast, and 8.3x the 2020 estimate. There is a reasonable possibility that the low valuation accurately reflects a temporary period of lower earnings. However, this raises an interesting theoretical exercise, since the company is 57.8% owned by Roger Penske (founder and current CEO/Chairman) and Mitsui – leaving a float-adjusted market capitalization of only $1.6 billion.

If Penske could borrow at 6%, it could pay a 100% premium, or $3.2 billion, for the remaining publicly-held shares outstanding, resulting in additional annual interest expense of $192 million. Since the company generated $604 million of pre-tax income in 2018, there would be adequate interest coverage to engage in such a transaction (although cyclically depressed earnings would clearly lower this coverage ratio). This is not to presume that a management-led buyout will necessarily occur, but simply to illustrate how a low valuation provides some value-creating pathways at the company's disposal.

In the absence of a broader transaction, it is not difficult to construct a scenario in which the Penske shares could return at least 10% per annum. The current $1.58 per share dividend amounts to a 3.3% yield. In light of the company's longer-term 14.3% per share earnings growth record, if even half of this rate were generated, the implied annual return would exceed 10%. It is important to point out that Penske only has a 1% share of the U.S. automotive retail market. Its strategic policy of gradually consolidating both local and national franchises through acquisitions, cash flow permitting, could continue for decades, given the number of independently owned dealership franchises. Thus, this industry dynamic suggests that there is more than ample long-term capacity for Penske to expand at the historical rate.

Moreover, the company's discounted valuation is roughly 35% below the average P/E since 2007 of 12.9x. If this were viewed over the life of the auto retail cycle, there would then be an additional 55% of potential valuation-associated return if the shares ultimately were to trade at a normal earnings multiple.

Therefore, if one is willing to accept the possible decline in the Penske earnings over the near-term, which, in the paradoxical way of the market, appears to be already reflected in the valuation, a longer time horizon could well be rewarded with a reasonable low double-digit rate of return. Accordingly, the Penske Automotive Group shares are recommended for purchase.

## Company Description

Penske operates through three segments, which are Retail Automotive Dealership, Retail Commercial Truck Dealership, and Commercial Vehicle Distribution. In addition, the company owns a 28.9% interest in Penske Truck Leasing.

Through the Retail Automotive segment, which generates slightly over 90% of total company revenue, Penske is the second largest automotive retailer in the United States, as measured by sales (AutoNation is the largest). It operates 149 franchises in the U.S. and 191 internationally. The domestic market is extremely fragmented, with an estimated 16,700 franchised new car dealerships, and twice as many independent used car dealerships[1]. Based on this, Penske has only 0.9% market share. Even AutoNation, which operates 326 new vehicle franchises in the U.S., only captures 1.9% of the overall market. Given this, it is easy to understand why the primary growth strategy of these companies is to continually acquire dealership franchises and consolidate the industry.

At the end of 2018, about 70% of the Penske automotive retail sales were derived from luxury brands such as Audi, Mercedes-Benz, and Jaguar. Specifically, BMW/MINI accounted for 23% of all automotive revenues, as shown below.

**Exhibit 1: Penske Automotive Revenue, by Brand**

| Brand | % of Auto Revs |
|---|---:|
| BMW/MINI | 23% |
| Audi | 13% |
| Toyota | 10% |
| Mercedes-Benz | 9% |
| Land Rover/Jaguar | 9% |

Source: Company reports

The focus on international luxury automobile brands is logical, as the company has a strong presence in the U.K. market. At the end of the third quarter of 2019, 55% of its dealership franchises were located outside of the U.S., such that almost half of overall company revenues were generated internationally (at the end of 2018, geographical revenues were: U.S. 56%, U.K. 35%, Germany/Italy: 6%, Australia/New Zealand 2%, Canada: 1%).

Penske also operates 15 used vehicle supercenters in the U.S. and U.K. that adopt a one price, "no haggle" customer strategy. In the U.S., these locations, six in total, operate under the CarSense brand primarily in the Philadelphia and Pittsburgh markets. In the U.K., Penske owns nine supercenter locations under the CarShop brand.

The vehicle manufacturers effectively regulate the margin dealers may earn on new car sales. Typically, dealerships obtain financing from the captive finance units of the manufacturers to purchase the vehicles directly and are then allowed to sell the vehicles at the suggested price. At the moment, Penske generates about $3,000 in gross profit per new vehicle sold. The margin produced on used vehicles depends on the price at which the dealership can

[1] According to the AutoNation 2018 Form 10-K

acquire the vehicle from the owner (or, in the case of wholesale transactions, the spread between the acquired auction price and the end retail consumer price). The current gross margin Penske records on used vehicles is roughly $1,300 per vehicle.

Thus, if Penske can only manage $3,000 in gross profit on a $40,000 new vehicle (an 8% *gross* margin), in order for auto retail to be a sustainable business, other sources of revenue are required. Along these lines, the service departments of most dealerships generate the bulk of earnings. For instance, in 2018 new vehicle sales represented 46% of the auto segment's total revenues, but only 24% of gross profit. In contrast, service and parts accounted for 10% of revenues and 42% of gross profit – clearly, a much higher margin business.

Additionally, Penske generates financing income when its customers obtain credit through its network of lenders. Importantly, Penske does not directly lend, and therefore does not have the associated balance sheet risk attached to a large receivables portfolio. The company simply collects an origination fee from the lender. This is very high margin – in 2018, finance produced 3% of segment revenues and 20% of gross profit. In the aggregate, service and finance represented 62% of total segment gross profit in 2018, highlighting the importance of these businesses to the dealership operating model.

**Exhibit 2: Penske Automotive Segment Profit Mix (2018)**

| Revenue Source | Total Gross Profit Contribution |
|---|---|
| Service and Parts | 42% |
| New Vehicle | 24% |
| Finance and Insurance | 20% |
| Used Vehicle | 13% |
| Fleet and Wholesale | 1% |
| | 100% |

Source: Company reports

Penske's second operating segment is Commercial Truck Retail, branded in the marketplace as Premier Truck Group ("PTG"). This is still a relatively small segment, comprising 6% of total company revenues in 2018. Nevertheless, PTG operates 25 locations throughout Utah, Idaho, Texas, Oklahoma, Tennessee, Georgia – and also a small operation in Canada. At these dealerships, Penske sells medium and heavy-duty trucks, primarily offering Western Star and Freightliner brands.

Whereas the company's new auto sales amount to about $40,000 per vehicle, the truck group generates almost $112,000 per unit. Since the gross profit dynamic is not dramatically different than that of new auto sales—it generates roughly $4,500 in gross profit per truck sold—Penske relies heavily on service revenue to generate additional income. For example, during 2018, new truck sales accounted for 63% of segment revenues, and only 19% of gross profit. On the other hand, service and parts comprised 67% of segment gross profit.

The third primary segment is Commercial Vehicle Distribution. Penske is an importer and distributor of heavy-duty trucks, primarily the Western Star (a Daimler brand), MAN (a VW Group brand), and Dennis Eagle, across Australia and New Zealand. In addition to the large semis, it also distributes buses and refuse collection vehicles. The other component of this business is the distribution of engines and power systems from brands such as Allison, Detroit Diesel, and Rolls Royce. The company's network includes delivery to over 70 dealership locations as well as several other branches and field locations. At the end of 2018, this segment produced 2.5% of total company revenues.

Lastly, the company owns a 28.9% interest in Penske Truck Leasing Co. L.P. ("PTL"), which originally was a partnership with GE Capital. GE recently divested its interest in this business, allowing Penske to increase its ownership, as well as expand the interest held by the Japanese conglomerate, Mitsui. A separate entity (also controlled by Roger Penske) known as Penske Corporation owns 41.1% of PTL, while Mitsui now owns the remaining 30%.

PTL provides a wide range of transportation and supply chain services, including truck rental/leasing, distribution center management, and dry van truckload management. This has become a substantial business over the last decade, and given the company's increased ownership, now accounts for a rather significant amount of Penske's overall earnings. Under the equity method of accounting, PTL contributed $130 million of income in 2018, which was 28% of total pre-tax earnings.

## Penske: Since the Last Recession

As a cyclical business, sales of new vehicles in the U.S. have declined in almost every recession since 1970. While automobiles are a necessity for much, although not all, of the population, it is a large expenditure that generally can be delayed during weak economic cycles. During the 2008/2009 recession, the revenues of the two largest new car retailers declined between 25% and 34%. Interestingly, CarMax, which is one of the largest used car retailers, only experienced a 9% reduction in revenues during that time, as perhaps more consumers chose to acquire a less expensive used vehicle during the recession.

**Exhibit 3: Car Dealership Revenues During the 2008-2009 Recession**

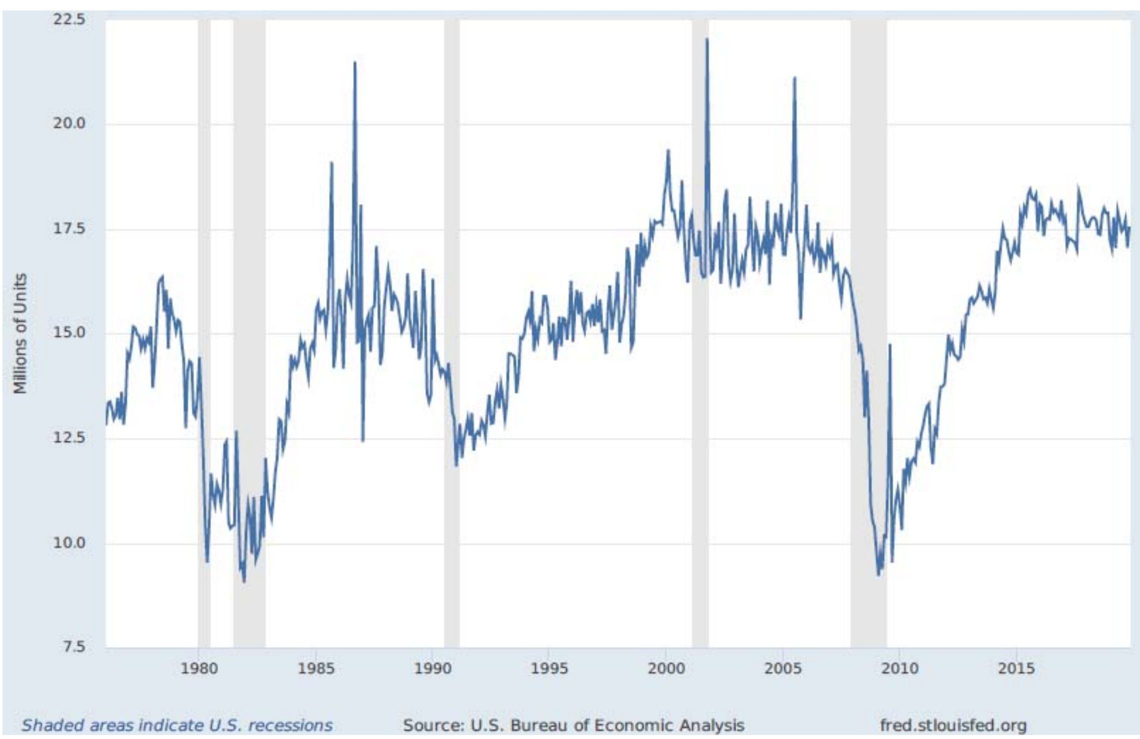
| Year | Penske | AutoNation | CarMax |
|---|---|---|---|
| 2007 | $ 12,782 | $ 16,385 | $ 8,200 |
| 2008 | 11,637 | 13,376 | 6,974 |
| 2009 | 9,523 | 10,758 | 7,470 |
| *Cum. Decline %* | *-25.50%* | *-34.30%* | *-8.90%* |

($ in millions)

Source: Company reports

After a sharp recovery that began in 2010, light vehicle sales have remained at the 16 million to 18 million annual unit range since 2015, as shown below. As this sales plateau has persisted for almost five years, many observers expect revenues for the industry to either remain at this level, or perhaps decline should recessionary pressures or consumer credit weakness appear.

**Exhibit 4: U.S. Light Vehicle Sales**




Source: St. Louis Fed

Irrespective of one's opinion on the future outlook, Penske has performed rather well since the lows reached in 2009. From that base of $9.5 billion in revenues, the company has steadily increased sales since, to the current $23 billion. Prior to the recession, Penske recorded revenues of $12.8 billion in 2007. The near doubling of revenues since that time has produced an annualized expansion rate of 5.4% - a reasonable growth rate for a cyclical, highly competitive, and quasi-margin constrained (meaning, the margin permitted by the auto manufacturers to the dealerships) industry. With some slight variations in certain years, the gross margin has remained consistent at roughly 15%.

**Exhibit 5: Historical Revenues and Gross Margins (2007-2018)**

| Year | Revenues | Gross Margin |
|---|---|---|
| 2007 | $ 12,782 | 14.80% |
| 2008 | 11,637 | 15.40% |
| 2009 | 9,523 | 16.60% |
| 2010 | 9,943 | 15.90% |
| 2011 | 11,127 | 15.80% |
| 2012 | 13,164 | 15.30% |
| 2013 | 14,483 | 15.20% |
| 2014 | 17,232 | 15.00% |
| 2015 | 19,285 | 14.90% |
| 2016 | 20,119 | 14.70% |
| 2017 | 21,387 | 15.10% |
| 2018 | 22,785 | 15.00% |
| *Annl'zd %:* | *5.40%* | |

($ in millions)

Source: Company reports

Similarly, operating income has risen annually by 6.3% during this time, and net income by 13.2%. The higher rate of profit growth can largely be explained by the increasing contribution of Penske Truck Leasing, which is an equity method investment. While there has been a very modest degree of operating margin improvement (2.7% in 2007 versus 2.9% in 2018), this alone cannot account for the dramatically higher net profit growth rate.

The earnings from Penske's 29% share of Penske Truck Leasing directly add to pre-tax income (i.e., 29% of PTL's net income is captured below operating income on the Penske income statement). As this business has grown over the last decade, and in conjunction with the additional interest purchased from GE Capital recently, the overall Penske earnings have benefited quite considerably. It should also be noted that the lowering of the U.S. corporate tax rate (resulting in a sizeable one-time tax-related gain for Penske in 2017) has also contributed to net profit growth since 2017.

**Exhibit 6: Historical Earnings Growth (2007-2018)**

| Year | Operating Income | Operating Margin | Net Income |
|---|---|---|---|
| 2007 | 339 | 2.70% | $ 120 |
| 2008 | 242 | 2.10% | n/a |
| 2009 | 209 | 2.20% | 76 |
| 2010 | 253 | 2.50% | 108 |
| 2011 | 296 | 2.70% | 177 |
| 2012 | 365 | 2.80% | 186 |
| 2013 | 430 | 3.00% | 244 |
| 2014 | 500 | 2.90% | 287 |
| 2015 | 567 | 2.90% | 326 |
| 2016 | 575 | 2.90% | 343 |
| 2017 | 611 | 2.90% | 613 |
| 2018 | 665 | 2.90% | 471 |
| *Annl'zd %:* | *6.30%* | | *13.20%* |

($ in millions)

Source: Company reports

Recently, though, the leveling of overall light vehicle sales both in the United States and in Europe has begun to apply some pressure to the company's revenues. Since Penske to some degree is continuously reshaping its dealership portfolio through acquisitions and disposals, it is important to evaluate year-over-year comparisons on a "same-store" basis to eliminate the distortion caused by frequent asset transactions.

During the first nine months of 2019, Penske suffered a 6.6% decline in new vehicle unit sales. While the average vehicle price did rise by 0.5% per unit, the increase was not sufficient, leading to a 6.1% erosion in overall new vehicle revenues.

**Exhibit 7: Penske Retail Automotive Dealership Year-to-Date New Vehicle Sales**

| | 9 Mos. Ended Sept. 30 | | |
|---|---|---|---|
| | 2019 | 2018 | *% Change* |
| Retail unit sales | 163,418 | 175,001 | *-6.60%* |
| Retail revenue (in millions) | $ 6,710 | $ 7,149 | *-6.10%* |
| Revenue per unit | $ 41,063 | $ 40,852 | *0.50%* |
| Gross profit per unit | $ 3,040 | $ 3,090 | *-1.60%* |

Source: Company reports

In somewhat of a contrast, the company's used vehicle business experienced unit sales growth of 0.8%, but the average selling price declined by 0.9%. Since the gross margin of this business is largely determined by the price at which the dealership can acquire the used vehicle, it appears that pricing dynamics in both the wholesale auction and consumer trade-in channels have tightened noticeably this year.

**Exhibit 8: Penske Retail Automotive Dealership Year-to-Date Used Vehicle Sales**

| | 9 Mos. Ended Sept. 30 | | |
|---|---|---|---|
| | 2019 | 2018 | *% Change* |
| Retail unit sales | 215,720 | 213,903 | *0.80%* |
| Retail revenue (in millions) | $ 5,446 | $ 5,495 | *-0.90%* |
| Revenue per unit | $ 25,244 | $ 25,690 | *-1.70%* |
| Gross profit per unit | $ 1,307 | $ 1,509 | *-13.40%* |

Source: Company reports

## Valuation

As noted previously, new and used vehicle retail is a very low margin business. Limited operational and organizational efficiencies can be achieved through consolidation, but on balance the owners of dealerships are still bound by prices established by the auto manufacturers.

Despite being one of the largest and most effectively-managed companies in the industry, Penske still generates a net profit margin in the 1% to 2% range. It is really difficult to imagine how this can ever be a substantially more profitable business unless manufacturers cede more profit to the dealers – a notion that seems highly unlikely.

Even so, a low margin business can still be a successful investment over the long run. If profitability can be maintained, and revenues increase at a reasonably high rate, the earnings will expand accordingly. In the case of Penske, it has also managed to repurchase about 14% of its shares outstanding over the last 10 years, which has assisted in creating a double-digit rate of per share earnings growth.

**Exhibit 9: Penske Margin and Earnings per Share History (2007-2018)**

| Year | Net Margin | EPS |
|---|---|---|
| 2007 | 0.90% | $ 1.27 |
| 2008 | n/a | n/a |
| 2009 | 0.80% | 0.83 |
| 2010 | 1.10% | 1.18 |
| 2011 | 1.60% | 1.94 |
| 2012 | 1.40% | 2.05 |
| 2013 | 1.70% | 2.70 |
| 2014 | 1.70% | 3.17 |
| 2015 | 1.70% | 3.63 |
| 2016 | 1.70% | 3.99 |
| 2017 | 2.90% | 7.14 |
| 2018 | 2.10% | 5.53 |
| *Annl'zd %:* | | *14.30%* |

Source: Company reports

Penske's largest competitor, AutoNation, similarly produces net profitability that does not greatly exceed 2%. It is interesting to observe CarMax, which is one of the largest retailers of used vehicles. CarMax produces a net margin of 4% to 4.5%, or double the profitability of the new car dealers. While the margin characteristics of used vehicle retail are not dramatically different and, in some case, inferior, CarMax does have a sizeable lending portfolio. It has chosen to use its balance sheet to facilitate vehicle financing. This has the effect creating a higher margin overall business but, of course, also exposes the company to credit risk. Despite the two distinctly different operating models, during periods of generally increasing or even slightly stagnant industry sales, the margins remain very consistent.

**Exhibit 10: Peer Industry Historical Profitability (2009-2018)**

| | Net Profit Margin | |
|---|---|---|
| Year | CarMax* | AutoNation |
| 2009 | 3.70% | 2.20% |
| 2010 | 4.20% | 1.90% |
| 2011 | 4.10% | 2.10% |
| 2012 | 4.00% | 2.00% |
| 2013 | 3.90% | 2.20% |
| 2014 | 4.20% | 2.20% |
| 2015 | 4.10% | 2.10% |
| 2016 | 4.00% | 2.00% |
| 2017 | 3.90% | 2.00% |
| 2018 | 4.60% | 1.90% |

*CarMax operates on a Feb. 28 fiscal year, so the above data represents the FY2019-FY2010 reported results

Source: Bloomberg

The valuations of the few, large publicly-traded car dealership companies are expectedly low. Penske is forecasted to earn $5.68 per share in profit in 2020, implying a forward P/E ratio of just 8.3x – although it is noteworthy that this estimate would suggest a prospective increase of 8% over the current year forecast of $5.25 per share.

Since 2007, Penske has traded at an earnings multiple of as high as 16x to a low of roughly 8x. The average multiple during this 12-year period has been 12.9x, which is mostly reasonable for a cyclical, low margin company. Nevertheless, this does demonstrate that during a normal cycle, the shares could be valued, on average, at a level that is 55% higher than at present.

It might also be mentioned that over the past four years, the Penske share price has remained relatively unchanged at the $44 to $50 range. Yet, the company's revenues have risen steadily, if modestly, and operating and net income have increased rather robustly. For whatever attributable reasons, the valuation has been contracting while the company appears to be operating consistently in all respects, and now has a base of earnings that is considerably higher than four years ago.

**Exhibit 11: Historical P/E Multiple (2007-2018)**

| Year | P/E |
|---|---|
| 2007 | 14.3x |
| 2008 | n/a |
| 2009 | 16.9x |
| 2010 | 14.3x |
| 2011 | 11.5x |
| 2012 | 16.1x |
| 2013 | 15.9x |
| 2014 | 15.3x |
| 2015 | 8.6x |
| 2016 | 13.6x |
| 2017 | 7.3x |
| 2018 | 8.5x |

Source: Bloomberg

In comparison, AutoNation trades at 10.8x the forecasted earnings of 2020. However, CarMax trades at nearly twice the valuation of Penske – 17.3x consensus 2020 profit estimates. CarMax has, at first glance, an advantage with respect to its financing business. The company does not have to solely rely on third party financing providers that may or may not extend credit to prospect car buyers. If done properly, CarMax can use its balance sheet as a tool to manage revenue and earnings growth. On the other hand, the credit quality of the loan portfolio can be placed into question at any point in time, particularly during recessions or after extended periods of unrestrictive consumer credit access. At the moment, this appears to be a risk that CarMax investors are willing to accept without much question.

*Possible Return Outcomes*

Penske is expected to generate $464 million of earnings in 2020. Of this, the company currently pays a dividend of $129 million, representing a 3.3% yield relative to the $3.8 billion market capitalization.

Since 2007, the company's long-term revenue growth rate has been 5.4% annually. Some modest margin improvements allowed operating income to expand at a 6.3% annual rate during this time. If this can be sustained, in addition to the dividend yield, it is not difficult to arrive at a reasonable 10%-type long-term return from the shares.

However, net income and per share earnings have been increasing at a far higher rate of 13% due to the increasing amount of income collected from the Penske Truck Leasing business, and from corporate share repurchases. Moreover, the currently depressed earnings multiple is 35% below the recent long-term average. When added to the base outcome, these factors could very well allow the investor to receive a return that noticeably exceeds 10% per annum over an extended period of time, irrespective of the perceived nearer-term earnings risk.

In a completely different scenario, it is worth examining the share ownership dynamic by the company's founder, Roger Penske Sr. Mostly through Penske Corp., he owns 42% of Penske Automotive Group. When adding the 15.8% ownership of long-time partner, Mitsui Corp. of Japan, the two collectively own 57.8% of the company, leaving public shareholders with 42.2% of the available float.

With a float-adjusted market capitalization of only $1.6 billion, consider the following scenario. Penske could theoretically pay a 100% premium for the remaining shares held by the public, representing a total value of $3.2 billion. If it could borrow at a 6% rate, the annual interest expense would be $192 million. Relative to pre-tax earnings of $604 million in 2018, the company could easily cover the interest payments in a normal industry cycle.

In this theoretical example, Penske would "go private" as a leveraged company. It currently has $2.4 billion of debt, $78 million in cash, and $2.6 billion of shareholders' equity. In order to finance the purchase of its vehicles from the manufacturers, it has borrowed $3.9 billion in floor plan notes payable. This debt is generally, but not always, non-recourse to the company and, as stated previously, often extended by the finance divisions of the large manufacturers. Nevertheless, adding another $3.5 billion of recourse debt to the balance sheet to buy out public shareholders would certainly place the company in a leveraged position.

Therefore, this is not to imply that the company will engage in such a transaction. Rather, it is meant to demonstrate the possibilities that are available while the shares trade at this low valuation. Apart from the normal earnings cyclicality, shareholders could experience a not unsubstantial return in any number of ways.

## Summary and Recommendation

Penske is a well-managed operator of new and used vehicle dealerships. In the last decade or so, it has diversified into heavy-duty truck sales as well as truck leasing and distribution. Given that these are all cyclical businesses, the investor community currently believes that a decline in vehicle sales is imminent. Since this would undoubtedly damage the Penske earnings, the shares trade at less than 9x the 2020 earnings forecast. However, this short-term focus provides for a range of possibilities over a longer time horizon – all to the advantage of the investor. In the absence of a more substantial or strategic transaction, Penske appears quite capable of producing at least a 10% return per annum merely through the maintenance of the current operating strategy. Accordingly, the Penske Automotive Group shares are recommended for purchase.

**PENSKE AUTOMOTIVE GROUP, INC.**
**CONSOLIDATED CONDENSED BALANCE SHEETS**

| | September 30, 2019 | December 31, 2018 |
|---|---|---|
| | (Unaudited) (In millions, except share and per share amounts) | |
| **ASSETS** | | |
| Cash and cash equivalents | $ 77.5 | $ 39.4 |
| Accounts receivable, net of allowance for doubtful accounts of $5.6 and $5.4 | 967.3 | 929.1 |
| Inventories | 4,043.9 | 4,040.1 |
| Other current assets | 98.8 | 86.6 |
| Total current assets | 5,187.5 | 5,095.2 |
| Property and equipment, net | 2,309.3 | 2,250.0 |
| Operating lease right-of-use assets | 2,384.4 | — |
| Goodwill | 1,876.5 | 1,752.0 |
| Other indefinite-lived intangible assets | 547.4 | 486.2 |
| Equity method investments | 1,362.8 | 1,305.2 |
| Other long-term assets | 21.6 | 15.9 |
| Total assets | $ 13,689.5 | $ 10,904.5 |
| **LIABILITIES AND EQUITY** | | |
| Floor plan notes payable | $ 2,444.1 | $ 2,362.2 |
| Floor plan notes payable — non-trade | 1,410.6 | 1,428.6 |
| Accounts payable | 672.3 | 598.2 |
| Accrued expenses and other current liabilities | 722.2 | 566.6 |
| Current portion of long-term debt | 96.8 | 92.0 |
| Liabilities held for sale | 0.5 | 0.7 |
| Total current liabilities | 5,346.5 | 5,048.3 |
| Long-term debt | 2,282.5 | 2,124.7 |
| Long-term operating lease liabilities | 2,334.7 | — |
| Deferred tax liabilities | 620.7 | 577.8 |
| Other long-term liabilities | 446.0 | 519.0 |
| Total liabilities | 11,030.4 | 8,269.8 |
| Commitments and contingent liabilities (Note 11) | | |
| **Equity** | | |
| Penske Automotive Group stockholders' equity: | | |
| Preferred Stock, $0.0001 par value; 100,000 shares authorized; none issued and outstanding | — | — |
| Common Stock, $0.0001 par value, 240,000,000 shares authorized; 81,066,927 shares issued and outstanding at September 30, 2019; 84,546,970 shares issued and outstanding at December 31, 2018 | — | — |
| Non-voting Common Stock, $0.0001 par value; 7,125,000 shares authorized; none issued and outstanding | — | — |
| Class C Common Stock, $0.0001 par value; 20,000,000 shares authorized; none issued and outstanding | — | — |
| Additional paid-in capital | 317.2 | 477.8 |
| Retained earnings | 2,607.7 | 2,365.8 |
| Accumulated other comprehensive income (loss) | (286.0) | (234.5) |
| Total Penske Automotive Group stockholders' equity | 2,638.9 | 2,609.1 |
| Non-controlling interest | 20.2 | 25.6 |
| Total equity | 2,659.1 | 2,634.7 |
| Total liabilities and equity | $ 13,689.5 | $ 10,904.5 |

**PENSKE AUTOMOTIVE GROUP, INC.**
**CONSOLIDATED CONDENSED STATEMENTS OF INCOME**

| | Three Months Ended September 30, | | | | Nine Months Ended September 30, | | | |
|---|---|---|---|---|---|---|---|---|
| | 2019 | | 2018 | | 2019 | | 2018 | |
| | (Unaudited) (In millions, except per share amounts) | | | | | | | |
| Revenue: | | | | | | | | |
| Retail automotive dealership | $ | 5,155.4 | $ | 5,148.5 | $ | 15,442.9 | $ | 15,900.0 |
| Retail commercial truck dealership | | 692.3 | | 385.3 | | 1,451.4 | | 1,016.5 |
| Commercial vehicle distribution and other | | 119.9 | | 124.8 | | 393.5 | | 429.3 |
| Total revenues | | 5,967.6 | | 5,658.6 | | 17,287.8 | | 17,345.8 |
| Cost of sales: | | | | | | | | |
| Retail automotive dealership | | 4,407.9 | | 4,386.3 | | 13,159.0 | | 13,561.5 |
| Retail commercial truck dealership | | 605.7 | | 327.5 | | 1,251.9 | | 859.7 |
| Commercial vehicle distribution and other | | 84.3 | | 92.2 | | 287.9 | | 317.8 |
| Total cost of sales | | 5,097.9 | | 4,806.0 | | 14,698.8 | | 14,739.0 |
| Gross profit | | 869.7 | | 852.6 | | 2,589.0 | | 2,606.8 |
| Selling, general and administrative expenses | | 672.8 | | 662.8 | | 2,008.1 | | 2,001.3 |
| Depreciation | | 27.5 | | 25.9 | | 81.0 | | 77.2 |
| Operating income | | 169.4 | | 163.9 | | 499.9 | | 528.3 |
| Floor plan interest expense | | (21.4) | | (20.2) | | (64.2) | | (59.0) |
| Other interest expense | | (32.9) | | (28.3) | | (93.2) | | (86.7) |
| Equity in earnings of affiliates | | 43.3 | | 41.7 | | 109.6 | | 95.0 |
| Income from continuing operations before income taxes | | 158.4 | | 157.1 | | 452.1 | | 477.6 |
| Income taxes | | (42.4) | | (27.1) | | (118.6) | | (104.7) |
| Income from continuing operations | | 116.0 | | 130.0 | | 333.5 | | 372.9 |
| Income from discontinued operations, net of tax | | 0.1 | | 0.1 | | 0.3 | | 0.2 |
| Net income | | 116.1 | | 130.1 | | 333.8 | | 373.1 |
| Less: (Loss) income attributable to non-controlling interests | | (0.1) | | (0.1) | | (0.4) | | 0.2 |
| Net income attributable to Penske Automotive Group common stockholders | $ | 116.2 | $ | 130.2 | $ | 334.2 | $ | 372.9 |
| **Basic earnings per share attributable to Penske Automotive Group common stockholders:** | | | | | | | | |
| Continuing operations | $ | 1.42 | $ | 1.53 | $ | 4.02 | $ | 4.37 |
| Discontinued operations | | 0.00 | | 0.00 | | 0.00 | | 0.00 |
| Net income attributable to Penske Automotive Group common stockholders | $ | 1.42 | $ | 1.53 | $ | 4.03 | $ | 4.37 |
| Shares used in determining basic earnings per share | | 81.6 | | 84.9 | | 83.0 | | 85.2 |
| **Diluted earnings per share attributable to Penske Automotive Group common stockholders:** | | | | | | | | |
| Continuing operations | $ | 1.42 | $ | 1.53 | $ | 4.02 | $ | 4.37 |
| Discontinued operations | | 0.00 | | 0.00 | | 0.00 | | 0.00 |
| Net income attributable to Penske Automotive Group common stockholders | $ | 1.42 | $ | 1.53 | $ | 4.03 | $ | 4.37 |
| Shares used in determining diluted earnings per share | | 81.7 | | 84.9 | | 83.0 | | 85.3 |
| **Amounts attributable to Penske Automotive Group common stockholders:** | | | | | | | | |
| Income from continuing operations | $ | 116.0 | $ | 130.0 | $ | 333.5 | $ | 372.9 |
| Less: (Loss) income attributable to non-controlling interests | | (0.1) | | (0.1) | | (0.4) | | 0.2 |
| Income from continuing operations, net of tax | | 116.1 | | 130.1 | | 333.9 | | 372.7 |
| Income from discontinued operations, net of tax | | 0.1 | | 0.1 | | 0.3 | | 0.2 |
| Net income attributable to Penske Automotive Group common stockholders | $ | 116.2 | $ | 130.2 | $ | 334.2 | $ | 372.9 |
| Cash dividends per share | $ | 0.40 | $ | 0.36 | $ | 1.17 | $ | 1.05 |

**PENSKE AUTOMOTIVE GROUP, INC.**
**CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS**

| | Nine Months Ended September 30, 2019 | Nine Months Ended September 30, 2018 |
|---|---|---|
| | (Unaudited) (In millions) | |
| **Operating Activities:** | | |
| Net income | $ 333.8 | $ 373.1 |
| Adjustments to reconcile net income to net cash from continuing operating activities: | | |
| Depreciation | 81.0 | 77.2 |
| Earnings of equity method investments | (77.8) | (69.5) |
| Income from discontinued operations, net of tax | (0.3) | (0.2) |
| Deferred income taxes | 48.2 | 64.3 |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | (38.0) | 6.1 |
| Inventories | 119.9 | 205.2 |
| Floor plan notes payable | 108.7 | (165.2) |
| Accounts payable and accrued expenses | 128.6 | 26.2 |
| Other | (43.3) | 18.7 |
| Net cash provided by continuing operating activities | 660.8 | 535.9 |
| **Investing Activities:** | | |
| Purchase of equipment and improvements | (188.8) | (188.5) |
| Proceeds from sale of dealerships | 7.3 | 58.4 |
| Proceeds from sale-leaseback transactions | 7.3 | 10.7 |
| Acquisitions net, including repayment of sellers' floor plan notes payable of $138.5 and $25.8, respectively | (326.9) | (168.6) |
| Other | (2.3) | (3.5) |
| Net cash used in continuing investing activities | (503.4) | (291.5) |
| **Financing Activities:** | | |
| Proceeds from borrowings under U.S. credit agreement revolving credit line | 1,458.0 | 1,163.0 |
| Repayments under U.S. credit agreement revolving credit line | (1,383.0) | (1,335.0) |
| Net borrowings of other long-term debt | 95.3 | 131.0 |
| Net repayments of floor plan notes payable — non-trade | (18.0) | (59.6) |
| Repurchases of common stock | (174.1) | (55.8) |
| Dividends | (97.3) | (89.7) |
| Other | 0.1 | (6.2) |
| Net cash used in continuing financing activities | (119.0) | (252.3) |
| Discontinued operations: | | |
| Net cash provided by discontinued operating activities | 0.2 | 0.3 |
| Net cash provided by discontinued investing activities | — | — |
| Net cash provided by discontinued financing activities | — | — |
| Net cash provided by discontinued operations | 0.2 | 0.3 |
| Effect of exchange rate changes on cash and cash equivalents | (0.5) | (0.5) |
| Net change in cash and cash equivalents | 38.1 | (8.1) |
| Cash and cash equivalents, beginning of period | 39.4 | 45.7 |
| Cash and cash equivalents, end of period | $ 77.5 | $ 37.6 |
| **Supplemental disclosures of cash flow information:** | | |
| Cash paid for: | | |
| Interest | $ 139.6 | $ 127.4 |
| Income taxes | 69.8 | 36.5 |
| Non cash activities: | | |
| Deferred consideration | — | $ 6.8 |
| Contingent consideration | $ 10.6 | — |

**PENSKE AUTOMOTIVE GROUP, INC.**
**CONSOLIDATED BALANCE SHEETS**

| | December 31, 2018 | December 31, 2017 |
|---|---|---|
| | (In millions, except share and per share amounts) | |
| **ASSETS** | | |
| Cash and cash equivalents | $ 39.4 | $ 45.7 |
| Accounts receivable, net of allowance for doubtful accounts of $5.4 and $5.5 | 929.1 | 954.9 |
| Inventories | 4,040.1 | 3,944.1 |
| Other current assets | 86.6 | 81.8 |
| Total current assets | 5,095.2 | 5,026.5 |
| Property and equipment, net | 2,250.0 | 2,108.6 |
| Goodwill | 1,752.0 | 1,660.5 |
| Other indefinite-lived intangible assets | 486.2 | 474.0 |
| Equity method investments | 1,305.2 | 1,256.6 |
| Other long-term assets | 15.9 | 14.4 |
| Total assets | $ 10,904.5 | $ 10,540.6 |
| **LIABILITIES AND EQUITY** | | |
| Floor plan notes payable | $ 2,362.2 | $ 2,343.2 |
| Floor plan notes payable — non-trade | 1,428.6 | 1,418.6 |
| Accounts payable | 598.2 | 641.6 |
| Accrued expenses | 566.6 | 523.5 |
| Current portion of long-term debt | 92.0 | 72.8 |
| Liabilities held for sale | 0.7 | 0.7 |
| Total current liabilities | 5,048.3 | 5,000.4 |
| Long-term debt | 2,124.7 | 2,090.4 |
| Deferred tax liabilities | 577.8 | 481.5 |
| Other long-term liabilities | 519.0 | 540.3 |
| Total liabilities | 8,269.8 | 8,112.6 |
| Commitments and contingent liabilities (Note 12) | | |
| **Equity** | | |
| Penske Automotive Group stockholders' equity: | | |
| Preferred Stock, $0.0001 par value; 100,000 shares authorized; none issued and outstanding | — | — |
| Common Stock, $0.0001 par value, 240,000,000 shares authorized; 84,546,970 shares issued and outstanding at December 31, 2018; 85,787,507 shares issued and outstanding at December 31, 2017 | — | — |
| Non-voting Common Stock, $0.0001 par value; 7,125,000 shares authorized; none issued and outstanding | — | — |
| Class C Common Stock, $0.0001 par value; 20,000,000 shares authorized; none issued and outstanding | — | — |
| Additional paid-in capital | 477.8 | 532.3 |
| Retained earnings | 2,365.8 | 2,009.4 |
| Accumulated other comprehensive income (loss) | (234.5) | (146.5) |
| Total Penske Automotive Group stockholders' equity | 2,609.1 | 2,395.2 |
| Non-controlling interest | 25.6 | 32.8 |
| Total equity | 2,634.7 | 2,428.0 |
| Total liabilities and equity | $ 10,904.5 | $ 10,540.6 |

**PENSKE AUTOMOTIVE GROUP, INC.**
**CONSOLIDATED STATEMENTS OF INCOME**

| | Year Ended December 31, 2018 | 2017 | 2016 |
|---|---|---|---|
| | (In millions, except share and per share amounts) | | |
| Revenue: | | | |
| Retail automotive dealership | $ 20,849.2 | $ 19,824.3 | $ 18,673.2 |
| Retail commercial truck dealership | 1,374.5 | 1,048.0 | 1,000.7 |
| Commercial vehicle distribution and other | 561.4 | 514.6 | 444.6 |
| Total revenues | 22,785.1 | 21,386.9 | 20,118.5 |
| Cost of sales: | | | |
| Retail automotive dealership | 17,790.6 | 16,899.5 | 15,968.4 |
| Retail commercial truck dealership | 1,163.0 | 882.2 | 857.8 |
| Commercial vehicle distribution and other | 416.6 | 382.7 | 325.7 |
| Total cost of sales | 19,370.2 | 18,164.4 | 17,151.9 |
| Gross profit | 3,414.9 | 3,222.5 | 2,966.6 |
| Selling, general and administrative expenses | 2,646.3 | 2,516.0 | 2,302.0 |
| Depreciation | 103.7 | 95.1 | 89.7 |
| Operating income | 664.9 | 611.4 | 574.9 |
| Floor plan interest expense | (80.9) | (63.4) | (50.9) |
| Other interest expense | (114.7) | (107.4) | (85.4) |
| Equity in earnings of affiliates | 134.8 | 107.6 | 69.5 |
| Income from continuing operations before income taxes | 604.1 | 548.2 | 508.1 |
| Income taxes | (134.3) | 64.8 | (160.7) |
| Income from continuing operations | 469.8 | 613.0 | 347.4 |
| Income (loss) from discontinued operations, net of tax | 0.5 | (0.2) | (1.0) |
| Net income | 470.3 | 612.8 | 346.4 |
| Less: (Loss) income attributable to non-controlling interests | (0.7) | (0.5) | 3.5 |
| Net income attributable to Penske Automotive Group common stockholders | $ 471.0 | $ 613.3 | $ 342.9 |
| **Basic earnings per share attributable to Penske Automotive Group common stockholders:** | | | |
| Continuing operations | $ 5.52 | $ 7.14 | $ 4.00 |
| Discontinued operations | 0.01 | (0.00) | (0.01) |
| Net income attributable to Penske Automotive Group common stockholders | $ 5.53 | $ 7.14 | $ 3.99 |
| Shares used in determining basic earnings per share | 85,165,367 | 85,877,227 | 86,000,754 |
| **Diluted earnings per share attributable to Penske Automotive Group common stockholders:** | | | |
| Continuing operations | $ 5.52 | $ 7.14 | $ 4.00 |
| Discontinued operations | 0.01 | (0.00) | (0.01) |
| Net income attributable to Penske Automotive Group common stockholders | $ 5.53 | $ 7.14 | $ 3.99 |
| Shares used in determining diluted earnings per share | 85,165,367 | 85,877,227 | 86,000,754 |
| **Amounts attributable to Penske Automotive Group common stockholders:** | | | |
| Income from continuing operations | $ 469.8 | $ 613.0 | $ 347.4 |
| Less: (Loss) income attributable to non-controlling interests | (0.7) | (0.5) | 3.5 |
| Income from continuing operations, net of tax | 470.5 | 613.5 | 343.9 |
| Income (loss) from discontinued operations, net of tax | 0.5 | (0.2) | (1.0) |
| Net income attributable to Penske Automotive Group common stockholders | $ 471.0 | $ 613.3 | $ 342.9 |
| Cash dividends per share | $ 1.42 | $ 1.26 | $ 1.10 |

**PENSKE AUTOMOTIVE GROUP, INC.**
**CONSOLIDATED STATEMENTS OF CASH FLOWS**

| | Year Ended December 31, | | |
|---|---|---|---|
| | 2018 | 2017 | 2016 |
| | | (In millions) | |
| **Operating Activities:** | | | |
| Net income | $ 470.3 | $ 612.8 | $ 346.4 |
| Adjustments to reconcile net income to net cash from continuing operating activities: | | | |
| Depreciation | 103.7 | 95.1 | 89.7 |
| Earnings of equity method investments | (89.0) | (68.9) | (50.0) |
| (Income) loss from discontinued operations, net of tax | (0.5) | 0.2 | 1.0 |
| Deferred income taxes | 105.9 | (108.7) | 162.2 |
| Changes in operating assets and liabilities: | | | |
| Accounts receivable | 30.4 | (73.1) | (92.5) |
| Inventories | (12.6) | (419.9) | 130.4 |
| Floor plan notes payable | 27.4 | 276.3 | (162.8) |
| Accounts payable and accrued expenses | (17.1) | 272.0 | (17.8) |
| Other | (4.3) | 37.2 | (35.3) |
| Net cash provided by continuing operating activities | 614.2 | 623.0 | 371.3 |
| **Investing Activities:** | | | |
| Purchase of equipment and improvements | (305.6) | (247.0) | (203.1) |
| Proceeds from sale of dealerships | 84.5 | 25.1 | 4.2 |
| Proceeds from sale-leaseback transactions | 10.7 | 22.2 | — |
| Acquisition of additional ownership interest in Penske Truck Leasing | — | (239.1) | (498.5) |
| Acquisitions net, including repayment of sellers' floor plan notes payable of $58.2, $101.6 and $62.2, respectively | (309.1) | (449.7) | (140.8) |
| Other | (5.7) | (40.2) | 1.5 |
| Net cash used in continuing investing activities | (525.2) | (928.7) | (836.7) |
| **Financing Activities:** | | | |
| Proceeds from borrowings under U.S. credit agreement revolving credit line | 1,642.0 | 2,040.0 | 1,476.5 |
| Repayments under U.S. credit agreement revolving credit line | (1,784.0) | (2,108.0) | (1,396.5) |
| Issuance of 3.75% senior subordinated notes | — | 300.0 | — |
| Issuance of 5.50% senior subordinated notes | — | — | 500.0 |
| Net borrowings of other long-term debt | 235.5 | 42.0 | 42.9 |
| Net borrowings of floor plan notes payable — non-trade | 10.0 | 185.3 | 101.0 |
| Payment of debt issuance costs | (1.9) | (4.0) | (6.7) |
| Repurchases of common stock | (68.9) | (18.5) | (173.6) |
| Dividends | (121.2) | (108.4) | (95.1) |
| Other | (5.8) | (5.8) | (15.5) |
| Net cash (used in) provided by continuing financing activities | (94.3) | 322.6 | 433.0 |
| Discontinued operations: | | | |
| Net cash provided by discontinued operating activities | 0.5 | 0.5 | 1.6 |
| Net cash provided by discontinued investing activities | — | 2.4 | 1.7 |
| Net cash used in discontinued financing activities | — | (0.2) | (0.2) |
| Net cash provided by discontinued operations | 0.5 | 2.7 | 3.1 |
| Effect of exchange rate changes on cash and cash equivalents | (1.5) | 2.1 | (9.1) |
| Net change in cash and cash equivalents | (6.3) | 21.7 | (38.4) |
| Cash and cash equivalents, beginning of period | 45.7 | 24.0 | 62.4 |
| Cash and cash equivalents, end of period | $ 39.4 | $ 45.7 | $ 24.0 |
| **Supplemental disclosures of cash flow information:** | | | |
| Cash paid for: | | | |
| Interest | $ 190.2 | $ 163.2 | $ 129.8 |
| Income taxes | 39.6 | (29.7) | 48.6 |
| Seller financed/assumed debt | — | 0.8 | — |
| Non cash activities: | | | |
| Deferred consideration | $ 6.8 | $ — | $ — |
| Consideration transferred through common stock issuance | — | 32.4 | — |
| Contingent consideration | — | 20.0 | — |

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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