Business conditions for the companies we follow in the Retail Automotive Industry have continued to improve since our November review. The U.S. economy appeared to perk up in the latter stages of 2011, despite fears that the recovery would stall in the face of declining personal incomes, still-weak housing and labor markets, and Europe's ongoing sovereign debt crisis. Moreover, new car sales have remained in an upswing after bottoming out in 2009 during the height of the financial crisis. And we expect 2012 to be another good year for the auto space, thanks to considerable pent-up demand and a gradual easing of lending/credit standards.

Against this healthier background, the publicly traded dealership groups are, by and large, seeing their fortunes rise. Some are benefiting from much greater earnings power than others, however, depending on the state of their cost structures, and the size of their high-margined used-car operations and ancillary product lines (i.e., parts & service and finance & insurance).

The aftermarket parts retailers, meanwhile, are also doing well, buoyed by favorable sector fundamentals. Chief among these is the rapidly aging fleet of vehicles on the road that are no longer under dealership warranty and are more frequently in need of repair. (The prime repair ages are between six and 10 years.)

The Auto Dealers

The domestic car market remains on the mend after cratering in 2009, when unit sales hit a 30-year low. In fact, U.S. auto sales rose 10% this past year, to an estimated 12.8 million units. And we anticipate another solid advance (in the high single-digits) this year, as consumers make the most of new financing options and trade in their aging vehicles for new ones. Notably, the average car on the road is now nearly 11 years old, the highest such tally on record. This, alone, should drive robust auto demand for many quarters to come.

That said, we do not see sales returning to pre-recession tallies anytime soon (of about 16 million units annually), not with the nation's unemployment rate still at 8.5% and the broader economy growing at only about a 2% pace. With this in mind, the national dealer groups we cover, namely *AutoNation*, *Asbury Automotive*, *CarMax*, *Group 1 Automotive*, *Penske Automotive*, and *Sonic Automotive*, continue to tighten their belts, cutting costs at the corporate and dealership levels, and looking to realize efficiencies in key areas like advertising and inventory management. Many are also rebalancing their brand mixes (usually to include a greater percentage of foreign and luxury models), so as to shield themselves from unpredictable changes in consumer preferences. This is true despite the resurgence of the influential Detroit OEMs. (General Motors, Ford, and Chrysler all gained market share last year, while Japan's automakers scrambled to recover from the natural disasters in Asia that disrupted key supply chains.)

In the meantime, once-popular growth-via-acquisition strategies are still out of vogue, particularly given the lack of attractively priced M&A opportunities these days. This may actually be good news for industry participants, however, since past deals often saddled companies with large debt loads, and failed to generate much in the way of revenue and cost synergies.

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The Aftermarket Parts Retailers

Prospects for the aftermarket retailers, *AutoZone*, *Advance Auto Parts*, *Pep Boys*, and *O'Reilly Automotive*, look very good, even though new car sales are picking up and demand for discretionary items, like cleaning agents, remains uneven. Aside from an aging vehicle population, these outfits are getting a boost from customer service enhancements, improved inventory management, new commercial programs, and remodeling initiatives. An acceleration in unit development is fueling growth in this segment, too. Following a lengthy contraction phase, square-footage growth is now back on the agenda. And financially sound firms are actively trying to penetrate underserved areas across the country.

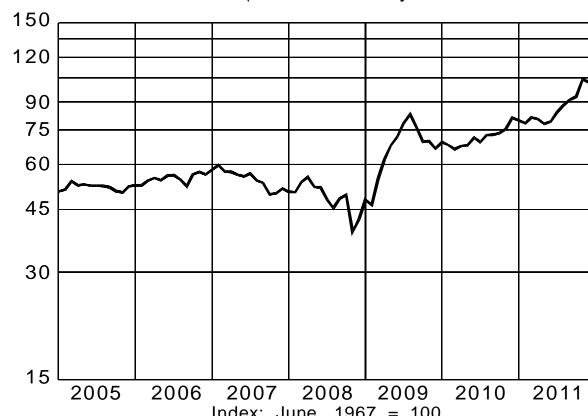
Conclusion

The Retail Automotive Industry, currently ranked in the upper third of the *Value Line* universe for year-ahead price performance, contains a few issues with appeal as either short- or long-term holdings. Investors are encouraged to carefully consult the individual reports that follow before committing funds.

Justin Hellman

Composite Statistics: RETAIL AUTOMOTIVE INDUSTRY

2007	2008	2009	2010	2011	2012		14-16
67327	67072	61845	69938	***75000***	***78500***	Sales ($mill)	***88000***
6.6%	6.3%	7.5%	7.8%	***8.0%***	***8.0%***	Operating Margin	***8.5%***
716.1	824.5	861.6	901.6	***925***	***950***	Depreciation ($mill)	***1150***
1828.7	1676.7	2067.9	2588.5	***2850***	***3060***	Net Profit ($mill)	***3500***
36.4%	36.6%	37.3%	37.3%	***37.5%***	***37.5%***	Income Tax Rate	***37.5%***
2.7%	2.5%	3.3%	3.7%	***3.8%***	***3.9%***	Net Profit Margin	***4.0%***
2665.4	2318.7	3668.3	3061.7	***3250***	***3500***	Working Cap'l ($mill)	***4000***
7344.4	7424.0	7511.5	11349.2	***11500***	***11500***	Long-Term Debt ($mill)	***12000***
11465.6	10418.0	11411.7	12024.2	***13250***	***14250***	Shr. Equity ($mill)	***15500***
11.0%	10.7%	12.1%	12.1%	***12.0%***	***12.0%***	Return on Total Cap'l	***13.0%***
16.0%	16.1%	18.1%	21.5%	***21.5%***	***21.5%***	Return on Shr. Equity	***22.5%***
14.8%	14.9%	17.8%	21.3%	***21.0%***	***21.0%***	Retained to Com Eq	***22.0%***
7%	7%	2%	1%	***2%***	***3%***	All Div'ds to Net Prof	***5%***
15.0	15.3	13.6	13.4	*Bold figures are Value Line estimates*		Avg Ann'l P/E Ratio	***15.0***
.80	.92	.90	.85			Relative P/E Ratio	***1.00***
.5%	.5%	.1%	.1%			Avg Ann'l Div'd Yield	***.2%***



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