Steering your dealership to higher profits

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February Monthly Profit Trends

February profit results for new vehicle dealers were very good. Our analysis of financial statements for January and February 2011 shows that 55% of new vehicle dealerships reported higher profits this year in February than January. In most years we expect profits to decline in February versus January. The number of dealers that reported a loss in February and February 2011 year-to-date approximates 10%. In prior years, the number of dealerships reporting year-to-date losses through February were as follows:

2010 20% 2009 45% 2008 35% 2007 40%

Nationwide new vehicle sales during January through March 2011 were up from the same months in 2010 and 2009. If the historical trend continues, April 2011 will be down from March 2011, but higher than April 2010 and 2009.

Life Insurance

Many dealers and their families have life insurance coverage. Most of these policies were bought when those insured were much younger, purchasing the policies to protect their families or for other reasons. We find that as these insured individuals become older and have less reason to have life insurance to protect their family, they quit paying the premium on these policies and let them expire. Before you allow a policy to expire because you no longer want to pay the premiums, you need to look at this policy from an investor's perspective.

Assume you have a policy in effect for $500,000 that has existed for many years, for a non-smoking male age 63 with a current premium of $6,000, to be kept in effect for another 6 years at this premium amount. The federal life expectancy table shows that this person is expected to live 18 more years. Let us assume that the remaining annual payments needed to cover premiums through age 81 (current age 63 plus 18 years) total $225,000. It seems to us that you would want to continue making the payments because the cost over the next 18 years would be $225,000 versus the payout amount of the policy at $500,000. Some dealers will look at what they have paid in the past and let those payments influence their decision to cancel the policy. You need to ignore what you have paid in the past and look at what you will have to pay in the future versus how much the payout will be upon death. You need to either keep making the payments to keep the policy in force and/or hire an insurance expert to advise on what you should do.

As an aside, we never understood why insurance companies wrote policies where the future premiums seemed to be much less than the face amount of the policy. The one answer we've heard several times is that many policy holders get tired of paying the premiums and let the policies expire. Insurance companies allow for this expiration while pricing some life insurance policies. Also, we know of entities that buy these policies from the insured. If these entities think the policies make a good investment, consider paying your premium, as in any other long-term investment.

Inside

Retail Installment Contracts

We subscribe to a service called Cross-Sell, which shows the number of new vehicles sold in various geographic areas and how many new vehicles each dealer sells along with a listing of top lien holders. The March 2011 lien holder report for Illinois lists the following liens by financial institutions:

Ally	4,852
American Honda Finance Corp.	3,275
Toyota Motor Credit Co.	3,186
Ford Motor Credit Co.	1,723
Enterprise Leasing	2,348
BNY Mellon Trust Co.	1,678
Chase	1,712
Nissan Motor Acceptance	1,759
Harris Bank	1,222
Hyundai Motor Finance Co.	892
US Bank	988
Bank of America	945
Wells Fargo Dealer Services	714
Volkswagen Bank USA	767
Fifth Third Bank	739

If you think you need more financial institutions to purchase your retail installment contracts, you might obtain this report to see who purchases these retail installment contracts in your state.

Will is character in action.

Factory Relations

We have been directly involved in twenty-three arbitration cases along with many others in 2010 involving General Motors and Chrysler. Dealers that thought they were average or above in performance discovered that factories used various metrics presented to the arbitrators to argue otherwise. You can expect and we have already seen that factories will use nearly any negative metric to add a competitive like-franchise dealer, to try to terminate dealers, or to pressure dealers to do something they would not otherwise do, such as major building improvements or removing dual franchises.

There are generally four metrics that factories use to coax dealers to implement changes: new vehicle sales effectiveness, customer satisfaction, capital and working capital requirements, and profitability. We are writing this month about sales effectiveness.

New vehicle sales effectiveness as compared to competitors is regularly made available to dealers. If you are below your factory's average, you need to review these results. This would include:

Review quarterly how you rate on sales effectiveness.

If you believe you do not have your share of certain models in stock, do the following:

1. Check other like-franchise dealers to see if they have more than their share of models that you are short on. Keep track of these numbers in case you need them in the future to defend your performance.
2. Keep a record of correspondence between you and your factory representative regarding any inadequate inventory of certain models which is limiting your sales.
3. Request someone to analyze your market to see if the factory is accurate in how they measure your performance.

Many dealers spend little, if any, time assessing their sales effectiveness. By the time they find out, there are negative consequences and little to be done about them. Dealers need to check at least quarterly to measure their new vehicle sales effectiveness to determine if improvements need to be made.

Reconditioning Costs

A CFO from one of our well-run dealer groups asked what other dealers are spending on their used vehicle inventory for reconditioning costs. We assembled data from factory financial statements from over 50 new vehicle dealers. Below is a summary of our findings.

The average dealer reported spending $589 on reconditioning per used car and $701 per used truck, with an average front-end gross profit margin of $1,926.

The median dealer reported spending $579 on reconditioning per used car and $654 per used truck, with an average front-end gross profit margin of $1,845.

Used Vehicle Service Contract Sales

The enclosed survey shows used vehicle service contract sales. The overall used service contract sales percentage is 37%. If you drop the bottom 10% of dealers out of the survey, the average would then exceed 40%. As you can see, Chrysler dealers reported 37%; Ford dealers reported 38%; GM dealers reported 30%; and Imports reported 47%. Since the perception is that Import vehicles are better products, it is interesting to see Import dealers reporting a 47% used vehicle service contract penetration.

National New Vehicle Trends

We have been keeping track of national new vehicle dealer industry metrics and trends for over 30 years. One metric we have kept track of is new vehicles sold per 1,000 individuals. In 1982, there were 46 new units sold per 1,000 individuals. This metric increased to its highest in 1986 of 67. In 1999 it was 62 new units per thousand. Since 1999 this metric has declined to a low of 34 per 1,000 individuals in 2009. In 2010 it increased to 38. This increase could indicate that new unit sales nationwide will continue to improve.

Feel the fear, and do it anyway.