

Steering your dealership to higher profits

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December Profit Trends

Nationwide new vehicle sales as reported by *Automotive News* were up in December 2010 compared to December 2008 and 2009. December 2010 was also the best month in the last two years, excluding the Cash for Clunkers month of August 2009. January 2011 profits were higher than January 2008 and 2009, but were lesser than most months in either year.

Based on our statistics from the 200+ new vehicle dealers we serve and on information from the NADA through November 2010, 2010 had the best profit margin in over twenty years, same as 2002, with pre-tax net profit as a percentage of sales at 2.3%. Also, the percentage of new vehicle dealers losing money is down compared to the last few years. It is a quiet fact that new vehicle dealers had a very good profit year in 2010. We believe financial institutions are now becoming aware of this fact, as they are now loaning money to dealers, whereas in the past two years they were much less inclined to do so.

Factory Relations

Our offices serve over 200 new vehicle dealers on a regular basis, preparing dealership income tax returns and in many cases year-end financial statements. As part of this process, we inspect the accounting records of these dealerships. Part of this inspection involves looking at the new vehicle inventory schedules and factory incentive receivable schedules. At times, we will see in these dealers' factory incentive and rebate receivable schedules, individual credit balances. This practice is a concern, because many times these credit balances on individual vehicle serial numbers indicate the factory has paid the rebate/incentive even though the vehicle has not yet been sold by the dealer. When asking about certain payments/credits, many dealers have indicated that their factory representatives wanted the dealers to show the vehicles sold, with no benefit to the dealership, so the factories could report regionally/nationally extra new vehicle sales for the sales period involved. If a factory has several hundred or several thousand dealers, a few extra sales per dealer improves the numbers for the factory. We tell dealers not to go along with prematurely showing vehicles sold, but factory representatives insist otherwise. Some of these sales are dealership employees, "customers," dealer loaners, dealer "rental" vehicles, etc. We would suggest factory representatives and upper management stop pressing their field employees to have dealers report vehicles sold when they have not been. If a dealer is audited, their factory will be of no help.

Dealership Blue Sky

Existing dealers and public companies are again looking to buy additional dealerships. We have been involved in 10-20 possible sale transactions in the last few months, of which only one has closed because in almost all cases, the asking prices were unreasonable. We have been following the sale of new vehicle dealerships for over 30 years, and the most successful dealers are always looking to buy more dealerships if the numbers make sense. There have been short periods of time including late 2008 and early 2009 where potential buyers sat on the sidelines until they could see that the world of the automobile dealer was not ending. However, we have heard comments arguing that dealerships were not worth much more than hard assets until the public

companies came upon the scene. We could not disagree more. Dealers have been paying blue sky and at times large blue sky well before the public companies even existed, and will continue to do so.

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Lincoln

Early last year, GM testified that having less Cadillac dealers would sell more Cadillacs. Ford is now saying the same thing regarding its luxury brand, Lincoln. In our 30 years of experience with factories, they have almost always said that more dealers in more locations sell more vehicles of their franchises. This explanation changed in the arbitration period last year in which GM and Chrysler had to defend the termination of hundreds of new dealerships, especially those in rural areas. After the arbitration process started, GM and Chrysler changed their official position and re-instated hundreds of terminated dealers including those selling Cadillacs. We believe they realized that they had taken both sides of the same fact pattern, and more importantly realized that they would be giving up market share by abandoning the rural market.

Ford's attempt to terminate hundreds of Lincoln dealers seems likely to go down the same path. We expect, though hard to prove either way, that Ford will be giving up market share, and it will cost them in Ford and Lincoln sales by abandoning rural markets. As you can see below, the Lincoln brand has been losing annual volume for the last ten years. Ford is pressuring its Lincoln dealers to institute new policies and procedures to try and save Lincoln. These Lincoln dealers are basically the same dealers from ten years ago. The problem, as those in the industry know, is the product, not the dealers.

Year	New Lincolns	Ranking to Other Franchises
2000	193000	
2001	159000	
2002	150000	26
2003	159000	25
2004	139000	26
2005	123000	28
2006	120000	26
2007	131000	24
2008	107000	26
2009	83000	23
2010	86000	25

We also understand Ford is offering many dealers a settlement to terminate their franchise. Dealers are being told that they are being treated equitably. However, Ford is requiring dealers to sign non-disclosure agreements, indicating that Ford is hiding something. We have talked to several dealers about the termination amounts offered, and it appears Ford has different formulas for different dealers.

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You never know unless you *know* you know.

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CFO/Office Managers

Many dealers are not aware of how to measure the effectiveness of their CFO/office managers. Below are some questions to consider regarding their effectiveness:

1. How many complaints, valid or not, are made by department managers?
2. Is the monthly financial statement completed and on the dealer's desk by the fifth work day? This assumes the dealer allows the office to close out vehicle sales by the morning of the second work day.
3. For most months, are all balance sheet accounts reconciled, balanced, and adjusted by the end of the next month?
You probably will need your outside CPA to confirm this.
4. Is the work area of the CFO/office manager neat and clean? We have a saying: A cluttered, messy office equals cluttered messy books.

Retail Installment Contracts

We at times will see open accounts receivable balances on vehicle deals. Some amounts are still owed by the customer, or the dealer will be paying these amounts as a dealer rebate. In those cases (1) where the dealer has cashed the retail installment contract and has not received all of the customer's down payment or (2) if the dealer is paying part of the down payment, the dealer in many cases is in violation of the reserve agreement it has with that financial institution. The dealer should not have cashed the contract until the retail customer has paid all of their funds agreed to in the retail installment contract. Some wording we have seen on this includes, *Down Payment: Unless specifically disclosed on the contract, the down payment with respect to such contract was paid in full by the buyer, in cash, check, draft, immediately available funds, or in trade equity prior to bank's purchase of such contract, and no part of such down payment was loaned by dealer* (source of this wording unknown).

You need to verify that the above policies are being used by your dealership, for the consequences can be severe.

Dealership Gross Profit

We have included in this month's survey the total gross profit for each department of the dealership: new, used, parts, service, body shop, plus other income as a percentage of the total gross profit. Many outside the industry believe the new vehicle department creates most of the total gross profit of a dealership. Even if you assume other income is 100% generated by the new vehicle department, not one dealership generates 50% of the total gross profit from new plus other income included in this month's survey. As you can see, the used vehicle department generates more gross profit than the new vehicle department. We did analyses of these gross profit numbers and the ratios of gross profit by department to the other departments. Some observations are listed below:

1. If you assign all of the other income to the new vehicle department, the ratio of gross profit to each department is as follows:
New 32%, Used 31%, Parts 14%, Service 20%. (These percentages do not add to 100% because body shop is not included.)
2. Gross profit ratios between the departments are the same for the above-average dealers as compared to all dealers, and the below-average profit margin dealers, suggesting that the higher profit margin dealers did a better job managing their expenses than the average dealer.
3. The average net profit as a percentage of sales for the top 50% of dealers is 3.2% while the median is 3.0%. The average net profit as a percentage of sales is 2.2%, which is the same as reported by the NADA through November 2010.

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