

Steering your dealership to higher profits

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March Monthly Profit Trends

March was an outstanding profit month for many new vehicle dealers. It was the best profit month in years, and for some dealers it was their best profit month ever. As you can see below, 90% of dealers did better in March 2011 than February 2011, also a good profit month. The average dealer in most years makes 2% of sales or less. Shown below, 30% of dealers made 4% of sales or better, while 45% of dealers made between 2.1% - 3.9%. We found that dealers below these profit margins had above average expenses in several categories.

	Mar. Better Than Feb.	Mar. Worse Than Feb.	Profit Margin +4%	Profit Margin 2.1 - 3.9%	Loss YTD
Chrysler	80%	20%	15%	50%	0%
Ford	90%	10%	30%	45%	10%
General Motors	85%	15%	30%	45%	5%
Imports	95%	5%	35%	45%	25%
Overall	90%	10%	30%	45%	

As reported in *Automotive News*, new vehicle sales nationwide were up in March 2011 from February 2010 and March 2010. March 2011 was better than every month of 2010 and 2009, except August 2009, which was the Cash-for-Clunkers month. April 2011 reported fewer sales than March 2011, which we would normally expect based on the month-to-month trends of prior years. We continue to find profits up from prior years as a result of (1) very low interest rates, (2) new vehicle inventory close to the guideline of a 60 days supply or less, (3) expenses down from prior years, and (4) bankrupt dealerships and the terminations brought on by Chrysler and GM resulting in less competition.

Bank Checking Accounts

For almost all dealers, their substantial checking account balances are at risk from electronic theft. This theft can occur from dealership employees, third parties obtaining passwords from dealership or bank employees, or third parties compromising the bank's electronic files. Such theft can cause dealers substantial losses and even put some dealers out of business.

We have seen this theft happen five times in the last 3-4 years. When we discuss these thefts with banks, they assure us they will cover the loss if it's their own fault. In our experience, the banks will look out for their interest first and the dealer will come second. Bankers may issue a verbal promise, but we want such promises in writing detailing how the dealer will be protected. To help offset the damage of any theft, consider these options:

1. Increase your insurance coverage to cover the most that your exposure might be.
2. Limit in writing the maximum that any wire transfer can be at any time unless approved in writing by someone with proper authority.
3. Request that the bank notify the owner and CFO of any and all wire transfers when they occur.

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Factory Relations

We wrote last month that factories have been and will continue to use different metrics to terminate its dealers, to pressure their dealers to spend money on items they would not normally spend, or to try and add new factory franchise dealer points by being critical of existing dealers. As we wrote in the past, many terminated dealers believed they were performing well, but then found out otherwise at arbitration hearings.

Last month we also wrote about new vehicle sales effectiveness criteria. This month we will talk about the metrics that factories use (CSI, SSI, QCP, and other criteria) to attempt to measure how well the customer is treated by the dealer. The typical dealer receives a score percentage, say 90% satisfied customers, along with what percentile that compares the dealer to other dealers of the same franchise.

If a dealer satisfies 90% of their customers reasonably well or completely satisfies them, this would seem that the dealer meets minimum standards. However, 50% of the dealers in this group would be below average. Does this mean they are not doing a good job? Of course not. Being below average when the average is 90% does not mean the dealer is ineffective. However, most factories will "fight" with these dealers. What really is the material difference between completely satisfied and just plain satisfied?

We suggest dealers make sure they watch these scores on a monthly basis and make sure they are not substantially below average. More importantly, if they are below average, dealers should make sure it is just a minor percent below average. If you find you are in this category, write to your representative and discuss this and try to get a response from the factory representative that though you are below average, your scores are reasonable. If you find you are way below average and possibly in the bottom 5%, then you need to improve these scores to protect yourself from factory action in the future.

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**Everything that irritates us about others can
lead us to an understanding of ourselves.**

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Working Capital

All dealers have a working capital (current assets less current liabilities) guideline for their dealerships. Current assets include cash, receivables due in 12 months or less, inventory, prepaid assets, and other assets expected to turn into cash in the next 12 months. Current liabilities include accounts payable, new and used vehicle floor plan, notes payable due in the next 12 months, and other payables/accruals expected to be paid in the next 12 months. Each factory typically has its own formula for determining the working capital guideline for its dealers. In most cases, these guidelines are reasonable, and dealers need to meet them so they can operate properly. We find at times that dealers do not meet their factories' working capital guidelines and are unaware that they are below this standard.

Most factory financial statements have a line on page 1 indicating the factory working capital guideline. This amount has to be updated and changed by your office staff, and it is not usually something that is done automatically. Step 1, make sure the guideline is present on each month's financial statement. Step 2, acquire a document from the factory that shows the guideline amount. These two amounts should be equal.

We went through over 50 financial statements comparing each dealer's working capital guideline with their annualized sales. It appears the working capital guideline works out to approximate 4% of annual sales. If you find your working capital guideline to be less than 3% or more than 5%, we suggest you re-compute for yourself your working capital guideline. If you find a major difference, discuss this it with your factory representative. Your factory might use their calculation of working capital guideline against you in the future.

If you find your actual working capital to be below the guideline, you might find that some accounts on your financial statement are in an incorrect place which might improve your working capital when corrected. You might find that you need to obtain a capital loan to increase your working capital to meet minimum standards. If you are a GM dealer, you might have reasonable working capital, but GM has its own unique way of calculating the working capital guideline. Maybe GM will eventually decide that it does not know better than everyone else.

Advertising

The enclosed profit survey shows advertising metrics. Most factories have an advertising credit account separate from the gross advertising expense that dealers have for new and used vehicles. We have shown gross advertising expense and advertising credits separate from gross advertising along with gross new and used advertising (before credits) as a percentage of new and used gross profit plus other income. We find that much of other income is part of new and used gross and should be added to new and used gross profit to measure certain metrics. As you can see, gross advertising as a percentage of new and used gross profit plus other income is as follows: Chrysler at 12%, Ford at 9%, GM at 11%, Imports at 13%, and Overall at 11%.

We suggest to those dealers who are selling at the factory guideline for new units and that have limited new inventory and a reasonable ratio of new to used, that they not spend 15% or more on gross advertising. At some point the extra advertising does not generate enough additional sales to justify itself.

Landlord Waivers

Most dealers have at times signed or had their landlord sign a landlord waiver for the financial institution that has the dealer's new and used floor plans and capital loans. This landlord waiver allows the financial institution access to the landlord's collateral that it has with the dealer. This document includes keeping the landlord from holding the financial institution's collateral (new and used vehicle inventory) hostage. Most landlords just sign this document without reading it, and life goes on. At times, and with good reason, some landlords will not agree with this landlord waiver request from the financial institution. We have seen attorneys for large banks write agreements that are extremely one-sided that no one should sign. Areas of concern include the bank's payment of rent to the landlord while the inventory is still on the property if the dealer has defaulted on the rent. Also, we have seen landlord waivers where the bank agreement gives the bank access to collateral that in fact is part of the building.



Small opportunities are often the beginning of great enterprises.

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