POWER STEERING

Steering your dealership to higher profits

A publication of Woodward & Associates
Consultants to the Automotive Industry

Written by Carl Woodward **April 2017**

New vehicle dealers reflected improved profits in February 2017 versus January 2017. As you can see below, 55% of our new vehicle dealers had improved profits in February 2017 versus January 2017. The number of dealers in a loss position for the month of February and February y-t-d was 20%. Nationwide new car and light duty truck sales for January and February 2017 were very close to the same months in 2016. March 2017 was down from March 2016, but March 2016 was the 3rd best month in the last seven years and March 2017 was the 6th best month in the last seven years.

February Profit Trends

	FEBRUARY BETTER THAN JANUARY	FEBRUARY WORSE THAN JANUARY	FEBRUARY BEST MONTH	FEBRUARY 3.0% + PROFIT %	FEBRUARY MONTH LOSS	FEBRUARY Y-T-D LOSS
CHRYSLER	55%	45%	55%	40%	25%	20%
FORD	45%	55%	45%	15%	30%	30%
G.M.	70%	30%	70%	15%	15%	15%
IMPORTS	50%	50%	50%	25%	20%	25%
OVERALL	55%	45%	55%	20%	20%	20%

Floor Plan Interest Rates

Most gross floor plan interest rates we see are in a narrow range. The one rate that seems higher is Ford Motor Credit when you look at their gross floor plan interest rate. We understand they issue credits to dealers based on the retail paper the dealer purchases. However, at times this is a misleading credit for their buy rate, as the retail installment rate is not always competitive so this credit is really for retail installment contracts and not floor plan. You also need to allow for the insurance coverage and cost when analyzing floor plan interest costs and floor plan insurance coverage. Sometimes allowing for higher insurance costs, it may pay to have a slightly higher gross floor plan interest rate. If any reader feels that this is not accurate, feel free to call us anytime to discuss in more detail so you make an informed decision.

"The best preparation for tomorrow is doing your best today."
- H. Jackson Brown, Jr.

Inside

Service Contract Retro and Reinsurance Products

All dealers sell new and used service contracts. A typical example would be the retail selling price of $1,800 for a longer term contract with the dealer "cost" being $1,400. The dealership reflects the $400 gross profit in the finance department and "pays" the service contract vendor the $1,400 for the coverage. Though it is not part of this article, the average dealer sells its new and used retail customers 40% service contracts. This is as far as the transaction goes for some dealers. We suggest that dealers, other than the small dealers, sign up for the opportunity to make more profit than just this $400.

The possibilities are to be in a retro service contract program or a reinsurance program for additional profit opportunities. Many dealers for various reasons are not in one of these retro or reinsurance programs and are leaving thousands of dollars of profit opportunity on the table. The retro program is typically a program in an informal arrangement with a service contract broker or a finance and insurance administrator. In these arrangements, the administrator keeps a certain percentage of the above $1,400 service contract cost as a commission and the remainder is kept in a "position" where the funds are invested to earn interest income. Any service contract claims are paid from the $1,400 less an administrator servicing fee plus investment income. As this fund builds up and has a reasonable loss ratio, the dealer will possibly receive annual payments in two or three years from inception. When you sign up for this type of program, you need to be very careful to have someone knowledgeable with this type of program to review the administrator fee structure for reasonableness along with the wording of the agreements. As an example, we have seen these retro programs that when and if the dealer quits writing into this retro program, all the unearned funds, expected future profits are forfeited to the benefit of the administrator. These forfeited funds can amount to several hundred thousand dollars or more. At times, the dealer either did not read the agreements carefully or did not understand the consequence of the agreements including forfeiting the future earnings. We would never agree to forfeit the unearned premiums, future profits. As an acceptable alternative, you could have the agreement state that once no more service contracts are written there will be no more payments to the dealer until all of the contracts have earned out and there is no more risk to the administrator. At this time, maybe 5 years from now the administrator can pay you the remaining amount in your account. The tax rate of the retro program will typically be the personal income tax rate of the dealer, which is usually the maximum personal income tax rate in effect at the time the dealer receives payment(s).

The reinsurance company alternatives for the dealer is either ownership in an off-shore company or a U.S. company as a sole shareholder or shareholder with other dealers. The taxes incurred for this type of company will usually be less than the retro position. Dealers have to also be careful about the wording of the agreement for forfeitures that are unreasonable as written above. In summary, most dealers should be in a retro or reinsurance type of program for the sale of vehicle service contracts. A dealer will wind up with some of the underwriting and investment income that the service contract provider would have earned.

Vehicle Department "Direct" Profit

Since all manufacturers have different monthly financial statement formats, most of the time it is not easy to determine how effective a department's gross, expenses, and retained "net" profit are on a comparative basis. Below are some metrics and summary of how to quickly determine if your retained new and used department total gross profit including finance, insurance, and service gross income is after certain "variable" expenses. Ford comes the closest to having their financial statement compute this metric, which they call "selling gross."

Total Vehicle Department Gross Profit	100%
Sales person's compensation	
F & I person's compensation	
Sales department supervision	
Advertising and promotion expense – net	
Floor plan interest expense – net	
Company vehicle expense	
Pre-delivery net and policy expense	
Training-demo-loaner expense	
Less total vehicle department "direct" expenses (above expenses)	53%
Total vehicle department "direct" profit (median)	**47%**

We did a survey of over 50 new vehicle dealers' monthly financial statement to determine a reasonable vehicle gross profit retention after certain above expenses. The above 47% is the median metric for dealers. The average is slightly less due to some dealers having very low gross margins or lacking control of the above expenses. We suggest you compute the above metric and if you are much below 45% then you have opportunities to improve your dealership net profit.

Used Vehicle Inventory

The enclosed survey reflects day's supply of used vehicle inventory averaging 66 days. We have heard, like a lot of you, that having a larger day's supply the average gross profit margin will be less. We have heard some national used vehicle valuing services tell dealers they make more per vehicle by having a smaller and less "stale," fewer day's supply, used vehicle inventory. We computed from over 100 new vehicle dealers where those with the larger day's supply; highest 50%, and their average front end gross profit margin. We found in the survey that their average, higher day's supply dealers had a 87 day's supply, but their front end gross profit margin was $1,773. Though it does not make sense, the dealer's with a larger day's supply had a slightly higher used retail gross profit margin. INTERESTING.

Internal Revenue Service (IRS)

Many of you know from questions you have been asked this year by your CPA firm about reinsurance companies, that the IRS has caused terrible disruption and costs to thousands of business taxpayers. This relates to IRS Form 8886 which is a reporting form. The IRS wrote late in the Obama presidency Notice 2016-66 about reinsurance companies. The penalties a taxpayer might have to pay if they do not know they need to file this form or they do not complete it properly can be $50,000 or more. We have never seen such large penalties for a reporting form. If the IRS had considered what they were trying to accomplish, rather than disrupting so many taxpayers, they could have simply had a computer person extract all IRS Form 1120-PC returns that elected 831(b) with insurance profits exceeding $500,000 and other metrics. This would have been a better way to find out what is going on and whether any IRS abuses exist. It would have saved dealers, dealer stockholders, and those in similar industries with legitimate reinsurance companies tons of wasted time and fees, etc. If President Trump was aware of this last minute abusive IRS regulation, we would assume it would go away.

To Subscribe:
Send $96.00 (Annual Subscription) to:
Woodward & Associates
P.O. Box 1584
Bloomington, IL 61702
carlswoodward@cpaauto.com

For More Information:
Call (309) 662-8797
or Fax (309) 662-9438