POWER STEERING

Steering your dealership to higher profits

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For our new vehicle dealers that we serve, pre-tax net profits were minimally improved in November 2019 compared to October 2019. We do not normally expect to see this trend, but expect November 2019 to be down compared to October 2019 in pre-tax net profits. As you can see below, 15% of dealers had their best month of the year, 20% had pre-tax profits margins of 3.0% + from November sales, 20% lost in November and 15% are in a year-to-date loss. Nationwide new car and light duty truck sales were down in 2019 approximately 1% from 2018 selling 17,100,000 as reported by the *Automotive News*. Also, as you might have read, more of the factories now plan to "hide" their monthly results, lack of full disclosure, so we only really know what level they are selling new vehicles on a quarterly basis. What is their motive for this lack of disclosure?

Monthly Profit Trends

	NOVEMBER BETTER THAN OCTOBER	NOVEMBER WORSE THAN OCTOBER	NOVEMBER BEST MONTH	NOVEMBER PROFIT 3.0% + SALES	NOVEMBER LOSS MONTH	NOVEMBER Y-T-D LOSS
CHRYSLER	60%	40%	20%	15%	20%	20%
FORD	40%	60%	15%	15%	20%	20%
G.M.	65%	35%	15%	15%	25%	15%
IMPORTS	50%	50%	10%	25%	15%	15%
OVERALL	50%	50%	15%	20%	20%	15%

We have shown in this issue the November year-to-date financial results from a representative sample of our dealers. The pre-tax net profit as a percentage of sales is 2.1%, while the pre-tax net profit as a percentage of gross profit and other income is 16%. The National Automobile Dealers Association (NADA) through November 2019 reflects annualized sales of approximately $62 million for 2018 and 2019. Pre-tax net profit as a percentage of sales is 2.4% for 2019, up slightly from 2.3% for 2018. Return on equity was reported to be 24%. The pre-tax net profit annual margin has ranged since 2009 to November 2019 from a low of 2.2% to a high of 2.8%.

"Hard work pays off - hard work beats talent any day, but if you're talented and work hard, it's hard to be beat."
— Robert Griffin III

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Working Capital Guidelines

All manufacturers have a working capital guideline for their dealers. Working capital is total current assets less total current liabilities. Where the LIFO reserve is shown on the asset side of the balance sheet, the factories add back to current assets this LIFO reserve to obtain the "real" working capital. Working capital is the main indicator that the dealership has adequate liquidity to reasonably operate. We have found dealers that do not have certain assets and liabilities shown on the correct line of the balance sheet which will make the factories computation of working capital inaccurate. If you believe this might be the case for you, have your office manager review this or feel free to send us just page 1 of your balance sheet for our review. Also, some factories computation for their working capital guideline is too simplistic and computes an unreasonable guideline. If this applies to your dealership, it is worthwhile to review this with them if their computation seems excessive and you do not have that much working capital. We just reviewed approximately 200 dealership December 2019 financial statements for the factory working capital guidelines. We eliminated those dealer statements from the sample that had no guideline reported on page 1 and those that appeared to have working capital guidelines obviously mis-stated. We calculated the working capital guideline as a percentage of annual sales. Our average dealer had $60M in sales and a working capital guideline of 3.5%.

Public New Vehicle Dealership Stocks

There are six main public new vehicle dealership stocks: Asbury; Autonation; Group 1; Lithia; Penske; and Sonic. Below are the stock prices and metrics as of February 7, 2020. These stocks as you can see from the following information have done quite well.

	Current Price	Price-52 week high	Price-52 week low	Price/Earnings Ratio
Asbury	93.60	123.45	65.54	9.80
Autonation	43.45	53.19	32.83	10.20
Group 1	94.62	110.11	55.97	11.29
Lithia	133.90	165.27	79.75	11.89
Penske	50.16	53.81	41.26	9.70
Sonic	31.63	35.41	13.70	11.46

As you can see, there is a huge swing in values from their lowest value in the last 52 weeks versus the highest value in the last 52 weeks. However, the Price/Earnings ratio fluctuates in a narrow range.

Cash Management Accounts

Many dealers have what is called a Cash Management Account (CMA) with their floor plan lender. This is an account where dealerships can deposit some of their excess cash separate from paying down new and used vehicle floor plan loans. Some dealers think that cash they put into this CMA account is personal. It generally is not. We have to tell dealers that what really is going on is the dealer puts cash into the dealership, say $100,000. The dealership deposits these funds into their checking account. The dealership transfers the $100,000 to the CMA account. The accounting entry is to debit cash for $100,000 and credit notes payable to owners and then credit cash and debit CMA for $100,000. The CMA is owned by the dealership, not the dealer individual, but the dealership shows owing the dealer the net amount put in/loaned to the dealership. If you as a dealer have this type of CMA money investment, make sure the accounting is done this way and confirm every once in a while, by looking at the CMA statement that they reflect what you think the balance is.

Miscellaneous

We received from a dealer a copy of a letter from his floor plan lender from April 1981. Yes, 1981. The letter stated to inform the dealer that the New York prime interest rate is 17.0% and this will be his new interest rate on both his corporation floor plan and personal note. Interesting!

Estate Tax Planning

As some readers know, the estate tax exemption level for estate taxes in 2020 starts at $11,580,000 for a single and $23,160,000 for a couple. Most dealer's family net worth is less than this total of $23,160,000, but some do have a larger amount. We also find that most dealers do very little real estate planning until it is too late, if at all. Why do you care? The estate tax level used to be less than $5,000,000 and will fall back to $5,000,000 after 2025. Trying not to be political, when the Democrats next gain control of Congress and the Presidency, you can count on the current high level exemption of $23,160,000 to be materially reduced. This can cause many dealers to then owe millions of dollars of estate tax upon death. What should you do? Though it is not much, you can gift annually $15,000 per donee. Also, you can use your lifetime estate exemption and gift large amounts of your personal net worth now, if you are willing. You need to find an experienced estate attorney to plan now with gifts of assets, sales to family member of assets, etc. to minimize estate taxes. Do not put this off because you believe you will live forever or the estate tax exemption will not go down from its current high exemption level.

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