POWER STEERING

Steering your dealership to higher profits

A publication of Woodward & Associates
Consultants to the Automotive Industry

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May 2016 profits for new vehicle dealers were down slightly compared to April. The number of dealers that had their best month of the year was 15%, while 25% of the new vehicle dealers had a year-to-date net profit % of sales margin of 3.0% or better. These trends are similar to April 2016. Nationwide new car and light-duty truck sales were better in May 2016 than April 2016. June 2016 was down slightly from May 2016, but May had one more day in it than June.

May Profit Trends

	MAY BETTER THAN APRIL	MAY WORSE THAN APRIL	MAY BEST MONTH	MAY 3.0% PROFIT OF SALES	MAY LOSS MONTH	MAY LOSS Y-T-D
CHRYSLER	50%	50%	25%	10%	0%	5%
FORD	55%	45%	25%	25%	15%	10%
G.M.	45%	55%	10%	20%	15%	10%
IMPORTS	45%	55%	10%	40%	5%	5%
OVERALL	45%	55%	15%	25%	10%	5%

Factories Measuring Dealers New Vehicle Performance

As we all know, the factory measures the expected performance of its dealers selling new vehicles. Most of the time, the factory performance metrics are reasonable. However, they will pressure and at times try to terminate a dealer for having too low a new vehicle sales performance. Dealers should always read any negative performance letters and respond in some way if their dealership is well below the "average" performance expected by the factory. A recent case in New York State was a big win for dealers. The court system reported that GM did not weigh local market conditions adequately. Local market conditions could include a factory plant in your town not of your franchise; a natural boundary like a river or lake; misallocating the market and census tracks between a large dealer and a smaller dealer; import preference based on demographics, etc. We saw a factory report that had expected ratio new vehicle sales 9 (larger dealer in larger market-for the smaller dealer) to 8. If you drove around the market for an hour or two and talked to some of the customers in the market, it would be obvious the ratio should not be 9-8 but possibly something closer to 2-1. We find factories are very slow to admit market assignment error or to correct those errors. Dealers with low performing sales effectiveness need to respond to their factory. If you have to fight them in court or a state administrative hearing, you could spend in the six-figure range just to defend your position.

"To me, business isn't about wearing suits or pleasing stockholders. It's about being true to yourself, your ideas and focusing on the essentials."
– Sir Richard Branson

Inside

Estate Planning 2016

Main Goal: Reduce Estate Taxes (depending on the size of your estate)

Secondary Goal: Reduce Current Income Taxes

Planning for 2016:

1. Gift $14,000 per year annual limit (per spouse) to each child and grandchild.

   Objective: Minimize estate taxes.

2. Move life insurance out of your estate by having all insurance owned by an irrevocable life insurance trust. The value of the policy at the date of transfer is a taxable gift and can utilize the $14,000 annual gift exclusion. The life insurance trust should purchase second-to-die insurance to assist in paying any estate tax.

   Objective: Keep life insurance proceeds out of the estate and supply cash to pay estate taxes.

3. If you own real estate that is leased, place the real estate in a family limited liability company. The parents should have minimal ownership but maintain control while the kids own the remainder. You should have a 100% mortgage on recently purchased property and make the rent as high as possible.

   Objective: Minimize growth of the estate and minimize current income taxes for the family.

4. Use your lifetime gift exclusion of $5,450,000 lifetime limit (per spouse) and gift up to this amount to your children. Gift assets (including non-voting stock of the dealership) that you can control and assets that produce the most income and return on investment.

   Objective: Minimize growth of the estate and reduce current income taxes for the family.

5. Sell assets to your children that you can control and that produce the most income and return on investment.

   Objective: Minimize growth of estate and reduce current income tax for family.

6. Depending on the size of the estate and your children's finances, up to $5,450,000, per spouse, can be directed via your will to go to your grandchildren.

   Objective: Minimize estate taxes for the family.

7. Consider creating and funding an intentional defective grantor trust (IDGT). The trust grantor can pay the income taxes for the trust/beneficiaries.

   Objective: Minimize the growth of the estate and maximize annual gifting to family in excess of the $14,000 annual exclusion.

Used Vehicle Metrics

We advise our dealers if their average used retail front-end gross profit margins are much lower than others. In many cases, these dealers are using an internet valuing and pricing service which often correlates to their lower used front-end gross profit margins. We believe part of the reason for these low grosses is because the dealer is not using the internet service properly. We took a group of lower front-end gross dealers and compared them to two of their dealership metrics. The first metric was to see the ratio of new retail sales to used retail sales. We have been told more than once that with these lower used front-end grosses, the dealership will sell more used vehicles than it had in the past. In other words, its ratio of used to new would improve. We believe we could measure this by comparing the ratio of new to used retail unit sales. In the past, we found import dealers would sell more new retail than used retail units. For Chrysler, Ford, and GM, we usually found dealers would sell more used retail than new units. In this survey, we found for the lower gross used dealers, the ratio of new to used was .9 to 1. This is an indicator that these dealers are not selling more used than in the past because their ratio is similar to all dealers, especially Chrysler-Ford-GM dealers.

The second metric we used was to compare these dealers based on their net profit as a percentage of sales. For those dealers, we compared our overall group of dealers' net profit margins. We found the overall average net profit as a percentage of sales for this group of low used vehicle gross dealers was 1.0%. This is less than 50% of the average dealer. In summary, if you allow these below average front-end gross profit margins to continue, you will likely reflect a below average net profit as a percentage of sales and much less profits.

Public Auto Companies (New)

The six main new vehicle public auto companies include: Asbury; Autonation; Group 1; Lithia; Penske; and Sonic. Below, we have listed some of these companies' individual metrics and/or group metrics based on their 2015 annual reports.

	Asbury	Autonation	Group 1	Lithia	Penske	Sonic	AVG.
Annual Sales in Billions	7	21	11	8	19	10	12
Pre-tax Net Profit % Sales	4.1	3.5	1.7	3.3	2.6	1.5	2.8
Working Capital % Sales	5.1	-2.2	1.5	3.7	0.6	1.8	2.4
Tangible Net Worth % Sales	2.1	2.5	-2.3	5.8	0.5	0.5	1.5

We recognize Working Capital % Sales and Tangible Net Worth % Sales is not something you probably measure or recognize its relevance. We find the average dealer working capital standard approximates 3.5% and most dealers are well above this metric. The factories and automobile industry financial entities seem to have a higher requirement for the non-public new vehicle dealerships. The public companies pre-tax net profit as a percentage of sales is slightly above the average non-public new vehicle dealership as reported by the NADA, especially if an adjustment is made for LIFO.

Business Office Metrics

The enclosed metric reflects finance-insurance-service contract income after chargebacks, before compensation, per new and used unit retail. You can see the overall average approximates $775. We find that the amount of finance income is going down over time and leveling out to a certain degree. This might be due to dealers "surrendering" to government intrusion in dealer's pricing (probably necessary to minimize fights). There is still a wide range of performance between the lower 20% versus the upper 80%. Most of this difference is due to a lack of vehicle service contracts for the lower 20% of new vehicle dealers.