Steering your dealership
to higher profits

A publication of Woodward & Associates
Consultants to the Automotive Industry

Written by Carl Woodward **July 2018**

May 2018 was an improved net profit month as compared to April 2018. This is an expected trend where the month of May profits typically are more, and improved over April each year. As you can see below, 60% of new vehicle dealers made more profits in May 2018 than April 2018. The number of dealers that made 3.0% or higher net profit as a percentage of sales for May approximates 30%. If you are not in this group you might analyze your May 2018 financial statement to determine why you are less 3.0% + net profit as a percentage of sales. Nationwide new vehicle sales in May was the second best month of the year and the sixth best month since 2009. June was down just slightly from May (it is not known how much fleet sales contribute to these metrics).

May Profit Trends

	MAY BETTER THAN APRIL	MAY WORSE THAN APRIL	MAY BEST MONTH	MAY 3% NET SALES PROFIT	MAY LOSS MONTH	MAY Y-T-D LOSS
CHRYSLER	60%	40%	30%	15%	10%	10%
FORD	55%	45%	25%	35%	15%	15%
G.M.	65%	35%	20%	15%	10%	10%
IMPORTS	60%	40%	25%	40%	15%	15%
OVERALL	60%	40%	25%	30%	15%	15%

Labor Gross Profit

The enclosed survey reflects service department gross profit margins. As indicated, the average gross profit margin percentage and the median gross profit margin percentage are both 69%. You will see dealers with a gross profit margin as low as 51% to a high of 83%. If you find you are at one of the extremes, you might have your office staff and service manager review your labor gross profit margin metrics to confirm they are accurate.

"Success seems to be connected with action. Successful people keep moving. They make mistakes, but they don't quit."
-- Conrad Hilton

Inside

Income Tax Law and Opportunities	2
Public Auto Companies	2
Factory Warranty Audits	2
Monthly Sales and Profit Survey	3
Used Retail Vehicle Sales Effectiveness	4
Dealership Rents Including Leasehold Improvements	4

Income Tax Law and Opportunities

The new income tax law passed in December, 2017 is generally good for most new vehicle dealers. There are several things that can be done to reduce the 2018 and future year income taxes for new vehicle dealers other than what would previously reduce the income taxes.

Most dealership entities will receive a deduction or credit against the dealership taxable income as compared against 2017 and prior years. W-2 income, rental income, and certain types of other income only receive a very small tax reduction due to slightly lower tax rates. Consider the following possibilities:

1) Reduce your W-2 income that the dealership pays you. This is especially true if your W-2 income is more than $100,000 per year.

2) Reduce the rent the dealership pays, if owned by the dealer individually, as long as the rental income is still a reasonable amount.

3) Any "side" income such as service contract income, etc. that is generated by the dealership but paid on the "side" personally should be put into the dealership.

The above suggestions could save dealers thousands of dollars of income taxes each year depending on the facts and circumstance. We will be reviewing with our dealers in the near term about making the above changes, where appropriate, to reduce income taxes for 2018 and future years.

Public Auto Companies

There are six main new vehicle public auto companies listed on stock exchanges. They are Asbury; Autonation; Group 1; Lithia; Penske; and Sonic. We have listed below some of the main metrics for these six companies and the NADA for 2017 and some of our comments.

	Asbury	Autonation	Group 1	Lithia	Penske	Sonic	NADA
Pre-tax net profit % annual sales	3.2%	3.0%	2.0%	3.4%	2.6%	1.1%	2.3%
Working capital % annual sales	3.8%	-3.9%	1.2%	4.8%	0.1%	0.7%	3.6%
Tangible net worth	positive	positive	negative	positive	positive	positive	positive

The pre-tax net profit for public companies average for 2017, is 2.6%. The NADA reported 2.3%. However, if you allow for LIFO the difference is minimal. In other words the public companies' end result is close to privately owned new vehicle dealers. Also, as you can see above it appears the factories have a double standard on their requirements on working capital for public companies' versus our computation of factory required working capital being 3.6%. Four of the six public companies working capital metric is well below privately owned new vehicle dealers. Also, Group 1 as you can see, has negative tangible net worth, but almost all lenders to non-public new vehicle dealerships require positive tangible net worth.

Factory Warranty Audits

Many dealerships will have a factory warranty audit while they are a dealer. We have some various comments about these audits. First, we don't think all of your service department employees can meet all the factory requirements 100% of the time for the warranty work done. Based on this, the warranty auditor will always find something to chargeback. This is even the case where the customer's vehicle was under warranty and the dealership did perform repair work, but did not follow the "required" procedures and paperwork. Though the factory will not like it, you can always tell the customer, or threaten to tell the customer, that your factory "audited" your work and will not pay you or are going to chargeback the dealership its payment for the warranty work. You then tell the factory you are going to tell the customer this and expect the customer to pay you for the work. Most reasonable people would agree the dealership should be paid something for the work actually done, whether the "paperwork" was perfect or not. The factory will not like this but it might "soften" them up.

You might meet with your service manager a couple times a year to confirm he is performing all warranty work as required by your factory. You might ask him what categories your factory warranty reports reflect that the dealership is high in, and ask why? Often times, the service manager can call the factory for "special" approval for being "innovative" on the warranty paperwork.

Used Retail Vehicle Sales Effectiveness

Many dealers do not know what is a reasonable number of used retail vehicles to sell each month (opportunity). Most dealers just keep doing whatever they have in the past for selling used vehicles. If a dealer is selling new vehicles in a monthly volume based on factory expectations, then for most of these dealers there is not a large amount of sales/profit upside potential on selling more new vehicles. The largest opportunity for vehicle sales improvement and sales in general is with selling more used vehicles. For dealers that ask about more sales and profits, if they are new vehicle sales effective, we then look at their used retail vehicle sales. We look at the ratio of sold used retail vehicles to sold new retail vehicles. We recently did a survey for just Ford dealers. We found the average ratio of used retail to new retail to be 1.8. We found the median ratio of used retail to new retail to be 1.7. If your dealership is below this ratio it is an indicator you are missing used retail sales.

Dealership Rents Including Leasehold Improvements

Many dealers rent their facility from the owners of the dealership, though some dealers rent their facility from unrelated third party landlords. Two questions we are commonly asked relate to what the "rent" should be, and how to handle leasehold improvement issues. The most common answer is the rent, not including property taxes, maintenance, and insurance, should be about 8% of the value of the facility when the lease is signed. If there are material leasehold improvements paid for by the dealership, and included in the current value of the dealership property then the value should be reduced by most if not all of the leasehold improvement costs. That amount would then be multiplied by 8% to determine reasonable rent for the dealership to pay. If this is not done, the dealership will in effect be paying rent on the increased value of the improvements it paid for. When the dealership, whether related party landlord or not, is paying for a material amount of improvements, it should be negotiated how the value of these leasehold improvements will be dealt with at the end of the lease. To make it less complicated, it works better to have the landlord pay for all material improvements and adjust the rent accordingly.

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

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