POWER STEERING

Steering your dealership to higher profits

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January 2017 was a down month in profits for a larger percentage of dealers than we have seen in any month for the last 7 years. The number of dealers losing money for the month of January 2017 was 30%. Nationwide new unit sales were approximately the same in January 2017 compared to January 2016. However, fleet sales might have made a difference, along with other factors, in causing more losses for dealers and less dealers reflecting an average profit margin, 2.4%, than is the norm. February 2017 nationwide new car and light-duty truck sales were approximately the same as February 2016. At this point in time, it looks like the year will have the same trend of nationwide new vehicle sales as 2016.

January Profit Trends

	PROFIT RANGE 2.4% SALES OR MORE	PROFIT RANGE 0 - 2.4%	CURRENT LOSS LESS $20,000	CURRENT LOSS MORE $20,000
CHRYSLER	20%	50%	10%	20%
FORD	20%	55%	15%	10%
G.M.	15%	50%	10%	25%
IMPORTS	30%	35%	30%	5%
OVERALL	20%	50%	15%	15%

Parts Inventory

The enclosed survey reflects day's supply of parts inventory. As you can see, the average dealer reflects having a 61 day's supply of parts. The range by group, which may not be statistically valid be due to the size of the sample of 200 + dealers, is a low of 43 day's for imports to a high of 74 day's for Chrysler. For those dealers with more than a 90 day's supply, you need to meet with your parts department to justify why they are so far above average. The parts department should have a monthly report that reflects the amount of parts in inventory that have been in stock over a year. This category should be minimal, and by discussing it with the parts department, this stale group of parts should gradually go down.

"The most dangerous poison is the feeling of achievement. The antidote is to every evening think what can be done better tomorrow."
- Ingvar Kamprad

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Rent Metrics and Issues

Most dealerships lease their facilities from related parties that determine the rent. Rent here does not include property taxes, insurance, or maintenance. Rent and Equivalent typically includes rent, property taxes and maintenance. We generally advise dealers that reasonable annual rent in today's low interest rate climate is 8% of fair market value of the facility. This means if you have property valued at $5,000,000, the annual rent would be $400,000. The NADA reported average Rent and Equivalent is 1.2% of annual sales or 10.7% of total gross profit. We would expect rent at newer factory current facilities to be slightly more than these averages.

There have been unforeseen legal issues where the dealer does not have a long-term lease, even if they are both the dealer and landlord. Some believe the lease amount should change often, but we believe it should change a minimum number of times over 20 years assuming the lease is a triple net lease, and if there is a rent increase, it might be 50% of the inflation increase for five years. Since it is a single-purpose facility, the landlord can expect the dealer not to leave; therefore, the cost increases on a triple net lease are zero to the landlord. The second unforeseen legal issue occurs if the dealership spends a substantial amount of costs on the facility. If this happens, whether related-party landlord or third-party landlord, we suggest the dealer enter into an agreement between the dealership and the landlord to allocate upon the sale of the facility or dealership how much the dealership will be reimbursed for its leasehold improvements. If this is not done, the landlord will likely receive a windfall on the facility improvements paid for by the dealership.

Parts Department Profitability

Each manufacturer has a different financial statement with different summaries and subtotals by department for department "profit." It is often not obvious how well or poorly a department is performing and contributing to the dealership by reading the financial statement. Ford has a term called "selling gross." We believe their metric is a good way to quickly compute if the direct expenses for a department are reasonable based on that department's gross profit.

PARTS DEPARTMENT GROSS PROFIT	100%
Parts compensation for all direct parts employees	25-30%
Advertising and promotion-direct	
Training	
Policy	
Service loaners	
Tools and supplies	
Freight	
Equipment and Vehicle supplies	
Inventory control	
Subtotal above misc. expenses	10-15%
Retained Department Gross after above direct expenses	55-60%

You can compute from your financial statement the above "selling gross" metric, and if the expenses exceed 40-45% of the parts gross profit, your expenses are out of line high for the size of the parts department. You should analyze your percentages and take action.

Re-insurance (Service Contract) Company

We talked to over 50 dealers in the last 60 days about the IRS requiring an information return, 8886, for re-insurance companies and whether dealers had an ownership in an offshore re-insurance company. We found that many dealers did not yet own an interest in these types of re-insurance companies. We believe most dealers, unless they sell less than 300 service contracts per year, should have a re-insurance company for the service contracts and certain other products like this that are already sold by their dealership. Those dealers that do not have such a company in many cases are missing substantial incremental profit opportunities. The most common type of re-insurance company is taxed as a U.S. taxpayer that elects to be taxed only on the investment income of the company. You should investigate your re-insurance company alternatives. These are details that can be worked out if you want to take advantage of the profit opportunities that you are now missing if you do not own an interest in a re-insurance company.

Public Auto Companies

We performed a financial analysis of the six public auto companies: Asbury, Autonation, Group 1, Lithia, Penske, and Sonic. This analysis was for September 2016 for five of the six public companies and June 2016 for the sixth public company. We wanted to see how the working capital and tangible net worth amounts on a percentage of sales basis compared to privately owned new vehicle dealerships. For these public companies, we found working capital was substantially below what we would expect the manufacturers to require. Our guideline is 3.5% of annual sales for reasonable working capital. If each of their dealerships meet our factory working capital guideline, then something does not make sense. The “mother” company of each of these public companies must have an extremely weak balance sheet or an innovative balance sheet compared to most non-public new vehicle dealerships. Tangible net worth (reported net worth less intangible assets such as goodwill, blue sky, franchise value) is very low and negative for Group 1. Using a guideline we developed for tangible net worth, five of the six public companies have a shortfall. From a legal perspective, how can these public auto companies be approved by their manufacturer for meeting manufacturer tangible net worth and working capital guidelines, but the manufacturers can try to pressure or terminate the non-public dealership for not meeting manufacturer tangible net worth or working capital guidelines?

Used Retail Gross Profit Margins

You see a wide range of front-end used retail gross profit margins in this month’s survey which we have discussed often in the past. You can see from the $600 range to well over $2,000. There is no valid reason front-end used retail gross profit margin should be less than $1,300 - $1,400. Those dealers with below average front-end used retail gross profit margins in almost all cases are below average in net profit as a percentage of sales. This metric should get your attention. We also believe there is no valid reason to accept such low gross profit margins, and with some management education and changes, this metric can be improved in a short period of time.

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