POWER STEERING

Steering your dealership to higher profits

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March 2016 pre-tax profit results were better than February 2016 profit results. This is expected based on prior year's profits for March versus February. Most dealers, 55%, had their best month of the year and 40% of dealers had a March net profit as a percent of sales of 3.0% or better. Loss dealers have the similar trend of the past from 5-10%. Unless you have some unreasonably high expenses for the size of your dealership in dollar sales, there is no good reason for you not to have at least minimal profits.

March Profit Trends

	MARCH BETTER THAN FEBRUARY	MARCH WORSE THAN FEBRUARY	BEST MONTH MARCH	MARCH 3.0% NET % SALES	MARCH LOSS MONTH	MARCH LOSS Y-T-D
CHRYSLER	55%	45%	55%	45%	0%	0%
FORD	55%	45%	50%	20%	10%	10%
G.M.	55%	45%	40%	40%	10%	5%
IMPORTS	75%	25%	75%	52%	5%	10%
OVERALL	60%	40%	55%	40%	5%	10%

Compensation Plans

Some dealers need to be concerned about the wording in their incentive pay plans. Many dealers pay employees on "vehicle gross profit" or some definition of "net profit." At times, dealers make certain accounting entries for valid reasons, but if the pay plan is matched up with the more conventional definition of "vehicle gross profit" or some definition of "net profit," the dealer would have difficulty in justifying the wording of the pay plan compared to the dealer's calculation of the incentive pay plan in court. Some of the concerns deal with "hard packs," "soft packs," putting some of the gross profit in the other income section of the financial statement, and how certain expenses are charged and allocated. If some disaffected current or prior employee files a complaint, you might have a difficult time defending the written pay plan versus the amount paid to the disaffected employee. There are wording options you can use to minimize this risk.

"Never be bullied into silence. Never allow yourself to be made a victim. Accept no one's definition of your life; define yourself."
-Dale Carnegie

Inside

New Vehicle Dealers Capital Structure

Dealers have several types of funds to financially support the operation, ignoring current debt such as new and used floor plan. The different financial categories include: capital or reported equity, long-term debt to dealer-owners (which is often subordinated to the third party lender), long-term debt to unrelated third party lenders and LIFO reserve which most knowledgeable lenders consider "capital" or "net worth."

We perform an analysis of the above structure at times to assist in advising dealers. This analysis includes public auto companies (6) as of December 31, 2015 and private capital dealers. In a recent analysis, we had 51 new vehicle dealers in our sample. Some of the metrics are as follows:

	PRIVATE AVERAGE	PRIVATE MEDIAN	PUBLIC AVERAGE	PUBLIC MEDIAN
Reported net worth	$2,800,000	$2,300,000	$1,162,000,000	$873,000,000
LIFO reserve	$1,600,000	$1,300,000	zero	zero
Note to Owner	$2,500,000	$1,400,000	zero	zero
Adjusted Net Worth	$6,900,000	$5,000,000	$1,162,000,000	$873,000,000
Long-term debt-third party	$ 820,000	zero	$1,090,000,000	$1,090,000,000
Third party debt / (net worth + LIFO+ Note to Owner + third party debt)	10%	zero	48%	
Working Capital Guide % Sales	3.6%			
Adjusted Net Worth % Sales	17%		9%	
Working Capital % Sales	8%		2% (only 5, one is negative)	

Private dealers have only 10%, most have zero, of total capital borrowed while public dealers have 48%. Private dealers have working capital of 8% of sales while public dealers have 2%. Is this factory discrimination?

Most private dealers do not have any unrelated third party long-term debt.

New Vehicle Inventory

The *Automotive News* (AN) reported an April 1, 2016 overall day's supply of new inventory to be 65. Their definition of day's supply is previous month's sales based on the following definition of inventory: unit count of vehicles on hand at dealerships, factory lots, ports of entry and in-transit on a specific date. We reflected in this newsletter our computed day's supply based on March 2016 sales versus new vehicles in stock on the ground at the dealership. Based on comparing the two differing definitions of inventory, *Automotive News* should always have a much larger day's supply because they count the following that we do not allow for: vehicles at factory lots, port of entry, and in-transit. Our day's supply in the enclosed survey of over 200 new vehicle dealers reflects 119. Fleet sales could account for some of the *Automotive News* lower day's supply of 65 versus our sample of over 200 dealers reflecting a 119 day's supply. We reflect Chrysler day's supply 148 vs AN 82, Ford 130 vs AN 80, and GM 128 vs AN 71. Our suggestion is to not rely on the *Automotive News* for new vehicle day's supply and do not always believe your factory representative's reason to order more new vehicles when you already have a 90 day's supply or more.

Year-End Used Vehicle Write-Downs

Most dealers write-down their used inventory at the end of the year. Some dealers put this write-down in a reserve account, which is what we prefer. This causes the used retail gross profits to be consistent starting with the beginning of the year. Some dealers pickup these write-downs in the first three months of the year as the cars are sold. If your used cars are pretty much “on the money” then the write-down is just for tax purposes. If so, we do not believe in picking the write-downs up, your used grosses will look too good or better than they really are. Your net profits will be over-stated, along with what pay your staff receives on the recapture of these used vehicle write-downs. We have another article on this subject if you want more information.

Used Vehicle Gross Profit Margins

The enclosed reflects front-end used retail gross profit margins by dealer groups from a low of $1,649 for Ford; $1,700 GM; $1,873 Imports; Chrysler $1,969; and overall $1,760. Those dealers that are making less than $1,500 need to make an effort to increase their front-end used retail gross profit margins. This lower gross profit margin is usually due to the skill level of the sales department or using a pricing service incorrectly.

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