POWER STEERING

Steering your dealership to higher profits

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March 2017 was a much improved profit month for most dealers. Almost 75% of the dealers in our survey, of more than 200 new vehicle dealers, had increased profits in March 2017 as compared to February 2017. Last year March 2016 had 60% of dealers making more profit in March 2016 than February 2016 versus 75% in 2017. Nationwide new vehicle sales in April were approximately the same as 2015 but down from April 2016. Nationwide new vehicle sales are down slightly on an April year-to-date basis. March 2017 was very close to March 2016 in our monthly profit trends for the 3% profit on sales and best month of the year columns.

March Profit Trends

	MARCH BETTER THAN FEBRUARY	MARCH WORSE THAN FEBRUARY	MARCH BEST MONTH	MARCH 3.0% OR BETTER	MARCH LOSS MONTH	MARCH Y-T-D LOSS
CHRYSLER	70%	30%	55%	20%	10%	10%
FORD	85%	15%	75%	40%	5%	15%
G.M.	60%	40%	50%	30%	10%	10%
IMPORTS	80%	20%	60%	40%	10%	15%
OVERALL	75%	25%	60%	40%	10%	15%

Though nationwide new vehicle sales are only down slightly from 2016, April 2017 we read articles about how "tough" it is along with "slower auto sales force tough choices in 2017." What "tough" choices or how is "tough" defined? We do not understand these negative comments (see later article- Nationwide New Vehicle Sales). Many authors of such articles perhaps do not realize the net profit as a percentage of sales has been close every year since 2009 in the 2.2% range. This includes years when new vehicle sales were much below what they are now. Many forget that much of the gross profit for new vehicle dealers is generated by the used vehicle, parts, and service department. If annual sales could remain at the 2016 and 2017 levels, the profits would continue to be good if dealers do not allow their expenses to increase by trying to increase sales from what they have been.

Ambition is the path to success.
Persistence is the vehicle you arrive in.
-Bill Bradley

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Desirability of Franchises

Often times we find industry experts and current dealers think the specific franchise is what matters when purchasing new vehicle dealerships. In other words, Toyota is more desirable than say Hyundai, which it is in many cases. As a general rule this is true, but some thought needs to be given to this notion. Is the buyer in the car business for "profit," larger profit stores, better return on investment, or what is the motive? If you can invest the same amount of money, in working capital and fixed assets, to earn say $1,000,000 per year in pre-tax profit, will you pay much more for blue sky for the more desirable franchise? Does it make more sense to pay $5,000,000 blue sky for Toyota in this example than say $2,000,000 for Hyundai, all other things being equal? We would say at times, Hyundai would be more desirable depending on many factors.

We recently heard someone say they would buy an Acura franchise and give up their existing Hyundai franchise for almost nothing. Their reasoning was that they could not get the Hyundai franchise reasonably profitable, therefore, get rid of it and try to obtain an even less "desirable" Acura franchise that they felt they could make profitable. Why? They have been unable to make the Hyundai franchise profitable. This is the key. We have one or two Hyundai stores that are marginally profitable and several that are extremely profitable. A Hyundai store needs to be run differently than many other franchises. One variable is the poorer performing Hyundai stores have weak management and don't know how to sell Hyundai's. Why do we think this? We have several Hyundai stores that make well more than 3% of sales with above average sales volumes in their locale. We find it a result of the skill level of the management team, not the Hyundai franchise. Another example is a Hyundai store that was very profitable for several years and then the GM left. This Hyundai store then started to break even and then began losing money over the next 2-3 years. The owner finally hired a qualified GM and once again this Hyundai store is very profitable by the third month the new GM started. This happened 2 years ago and the profits and new unit sales remain good. Another way to look at franchises is would you prefer to have 1 of 8 Toyota stores in a market or just 1 Hyundai store. Based on market penetration in this example the 1 Hyundai store should make more pre-tax profit and sell more new vehicles than the average of 8 Toyota stores. The point of this article is that you have to look at each possible franchise purchase and expected sales and profit margins and total expected profits. Sometimes the less desirable franchise will make more money than the more desirable franchise. If you have a poor profit performing franchise you need to look very hard at why it is a poor performer. Often times it is unqualified managers that have been tolerated for too long and don't know how to sell vehicles, manage expenses, and make money. If you have a poor performing store feel free to send us your financial statement. We would be glad to review it and discuss it with you at no charge.

Internal Revenue Service (IRS)

Below are some various comments that allow dealers to know, to a certain degree, some of the areas we believe the IRS handles poorly.

Thousands of Form 8300 (cash reporting - $10,000) with penalty notices of $250 each were sent to a large number of new vehicle dealers. Almost all the notices we have seen or heard about were sent in error. Someone at the IRS "screwed up" and had the date on the original Form 8300 entered incorrectly. This caused erroneous penalty notices to be sent. If anyone at the IRS had checked a couple of their forms they would have seen their date was wrong. All of the dates, all numbers, made no sense. The IRS even had a non-800 number to call. We called five times on behalf of our client and none of the calls were answered. Some dealers in a rush or to clear up a nuisance penalty notice paid the notice in error.

IRS auditors say they will respond promptly when an audit starts. Don't count on it. Often times they take several weeks to several months to respond to information dealers' CPA's send them within a week or 10 days of being requested. They usually say they are too busy. We then respond, don't try to have so many open audits so you can treat taxpayers in a professional and prompt way. Recently we did have an IRS supervisor make sure the audit kept moving along promptly. The audit was resolved professionally on both sides. An exception, not the rule.

IRS auditors make up stories when responding to reasonable questions. Apparently IRS auditors don't have to tell the truth but taxpayers are expected to tell the "truth."

IRS auditors have trouble with "materiality." We had one instance where the IRS wanted payroll taxes from an extremely large new vehicle dealer on gift cards of $50 that were given to a few dealer employees' children at a Christmas event. There were 33 $50 gift cards and the tax on this might have been $700.

What to do in the future:

Respond promptly to any IRS notices. We would not waste fees on over-night delivery, but require our staff to write down the date of response and by whom on all mail sent to the IRS. They at times lose dealer responses or have a "bad" date of receipt. If the IRS sends a second notice even though you timely responded to the first notice, then send them a response with proof of mailing.

New Vehicle Sales Ineffectiveness

We often ask dealers to send us their metrics that reflect what their factory expects them to sell in new vehicles annually. These are usually poor performing new vehicle dealers. We want to see how many new units the factory expects the dealer to sell per month, assuming the factory is reasonable. As an example, let's assume a dealer is selling 60 retail units per month, 35 new and 25 used. This is a common ratio. Also let's assume this dealer's factory tells them they should be selling say 55 new per month and corresponding 45 used per month. The first question we ask is how many full-time sales people does this dealer have? In this example, based on the "reasonable" factory metrics, this dealership should be selling 100 retail per month. Often times we find this dealership might only have 6-7 sales people. There is no way for most dealerships to sell 100 retail units per month with only 6-7 sales people. We suggest this dealer make a concerted effort to raise the number of sales people to 11 and terminate each month the lowest closing ratio sales person. It is amazing that this process usually works to a certain degree. Many dealers cannot see this solution, where a knowledgeable outsider will see the problem right away, more sales people are needed. If you are not meeting factory guidelines, could this example apply to your dealership?

Nationwide New Vehicle Sales

We read at times that experts in the industry are concerned that nationwide new vehicle sales might have leveled out and how "awful" this might be. We have a different perspective. Nationwide new vehicle sales have improved each year since 2009 and have appeared to level out this year. We remind dealers they are in business to make a profit. They are not in business to just sell more new vehicles. If you look at the national N.A.D.A metrics for pre-tax profits since July 2009, the pre-tax net profit percentage of sales have been in the range of 2.2 – 2.5% or better since July 2009. This profit margin range has been very good to new vehicle dealers. We are more concerned that this profit margin remains in the 2% range rather than dealers selling more new vehicles and having their profit margins and profits go down.

Service Contract Penetration

You can see in the enclosed survey new and used vehicle service contract penetration for an average dealer: 42%. This has been in this range, or slightly less the past few years. You can see the penetration percentage is almost the same for all franchise makes. If you find your penetration is less than 35%, you need to push the employees that sell this product or find replacement employees to sell this product.