



Steering your dealership to higher profits

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Written by Carl Woodward & Scott Woodward

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As we have seen, the net profits for April for new vehicle dealers probably were the worst in the last 50 years. Some states have completely shut down new vehicle dealers. Some do allow parts and service to be open with the sales department having restricted operations including requiring customers to call in for an appointment.

Most if not all of our new vehicle dealer clients have applied for the SBA PPP loans and most have received these loans. We heard that some dealers are putting a portion of these loan proceeds into profit in March and April. This should not be done and if it has been done, we suggest you back out that entry. Almost all dealers, we agree, are leaving these loan proceeds in notes payable until later this year when it is known how much of the loan might be forgiven.

Financial Fraud

An attorney who specializes in car dealerships wrote the following for us: “In 2019, an employee with the city of Chicago received an email from a vendor asking that future payments be wired to a new bank account. Instead of doing any sort of due diligence, the changes were made and a payment wired; the payment was over \$1.1 million. Luckily, a bank put a hold on the account and when the fraud was discovered a week later, Chicago got all its money back.” They were lucky, but this is not always the case.

Companies need to have procedures in place whenever a vendor, an employee, or customer asks to make changes to their account (especially regarding their bank account). At minimum, two people should be required to sign off on changes, and that verification should be done in person or by calling the person directly about the change. Keep in mind – you need to call the telephone number already on file, not one provided in the request for change.

“There are two types of people who will tell you that you cannot make a difference in this world: those who are afraid to try and those who are afraid you will succeed.”

-- Ray Goforth

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Carvana Co.

We see television advertisements on buying a vehicle over the internet and then showing the seller, Carvana, will deliver the vehicle to your address or the vehicle is picked up from a “vending machine.” We thought it might be worthwhile to review the annual (12/2019) and first quarter (3/31/2020) public reported financial statements. Below is from the SEC Form 10-K (annual) and SEC Form 10-Q (quarterly).

	Year	Quarter
	2019	3/2020
Used Vehicle Inventory	\$762,000,000	\$845,000,000
# Used Units – Inventory	25,977	33,500
# Units Retail	177,549	52,447
Retail Average Selling Price	\$19,300	\$18,400
Total Gross Profit per Unit (including F & I & SC)	\$2,852	\$2,640
Advertising	\$204,020,000	\$74,788,000
Advertising per Retail Unit Sold	\$1,149	\$1,425
Intangibles & Goodwill	\$17,000,000	\$16,000,000
Total Stockholder’s Equity	\$191,939,000	\$13,326,000
Sales	\$1,098,000,000	\$755,000,000
Net Profit (Loss)	(\$184,000,000)	(\$83,000,000)
Senior Notes Payable Interest Rate	8.75%	8.75%

Some comments on the above:

Their tangible equity (net worth) is negative (\$13,326,000 - \$16,000,000) as of 3/31/2020.

What lender would loan funds to this entity based on its negative tangible net worth?

Advertising per retail is more than 50% of the gross profit per unit.

How much of the used vehicle inventory is overstated of \$845,000,000 as of May 1, 2020?

How long can they stay in business losing so much with no tangible equity?

With the large borrowing interest rate being 8.75%, that is an indicator of “extremely high risk.”

“Would you like me to give you a formula for success? It’s quite simple, really: Double your rate of failure. You are thinking of failure as the enemy of success. But it isn’t at all. You can be discouraged by failure or you can learn from it, so go ahead and make mistakes. Make all you can. Because remember that’s where you will find success.”

-- Thomas J. Watson

SBA PPP Loan Metrics

As of May 10th the following metrics on these first round of SBA PPP loans were as follows:

Over \$5 million 4,417 loans	\$2 - \$5 million 21,566 loans	\$1 - \$2 million 41,238 loans
\$350,000 - \$1 million 140,197 loans	\$150,000 - \$350,000 224,061 loans	\$0 – 150,000 1,229,893 loans
Overall \$342 billion and 1,661,367 total loans	Average loan \$206,033	

Used Vehicles

We have measured three times in the past 36 months dealers with less than a 60 day supply of used vehicles versus dealers with more than 60 day's supply of used inventory. We wanted to see what the used retail front-end gross profit margin was for each group. We also wanted to see the ratio of used retail units to new retail units to measure used retail unit sales effectiveness. We found that dealers with a larger day's supply of used vehicles had a higher used retail front-end gross profit margin, though conventional thinking was it would be the other way around.

We just completed a random sample of over 100 new vehicle dealers' new and used metrics from December 2019 dealership monthly financial statements and found the same thing. This was before the current "Virus" downturn. Our new vehicle dealers business is now down substantially for the year for both new and used vehicle sales. Used vehicle values are also down, which makes the sales situation worse.

Finance - Insurance - Service Contract Chargebacks

We wanted to measure the total for the year finance-insurance-service contract chargeback as a percentage of total finance-insurance-service contract income before chargebacks. We found the top half in size of all dealers we measure reflected chargebacks being 15%. The average dealer in the bottom half of the sample reflected chargebacks being 12% with the overall median being 12%.

Many manufacturers have better accounting policies where the chargebacks for all three categories can be measured. However, the following manufacturers do not itemize all chargebacks: Audi, BMW, G.M., Jaguar-Land Rover, Kia, Mazda, Mercedes, Mitsubishi, Subaru, VW and Volvo.

“People who succeed have momentum. The more they succeed, the more they want to succeed, and the more they find a way to succeed. Similarly, when someone is failing, the tendency is to get on a downward spiral that can even become a self-fulfilling prophecy.”

-- Tony Robbins

SBA PPP Loan Forgiveness

Most factories have sent out emails/memos suggesting how to account for these SBA loans. We do not believe any of these factories read the terms of the SBA loans or understand basic accounting. These SBA loans are for 24 months with no payments starting until the 7th month. This is not considering at this time that the loan might be forgiven. As accountants know, loan payments due in less than 12 months are considered current liabilities versus long term liabilities. Based on the above terms, generally speaking 1/3 of the loan balance would be considered a short term liability and 2/3 of the loan balance would be considered long term, not all long term as written by most factories.

To Subscribe:
Send \$96.00 (Annual Subscription) to:
Woodward & Associates
P.O. Box 1584
Bloomington, IL 61702
carlswoodward@cpaauto.com
For More Information:
Call (309) 662-8797
or Fax (309) 662-9438