POWER STEERING

Steering your dealership to higher profits

A publication of Woodward & Associates
Consultants to the Automotive Industry

Written by Carl Woodward & Scott Woodward **September 2020**

July profits for most new vehicle dealers remained excellent and much more than in a typical month from 2010 – 2019, which were all good years. The enclosed survey reflects excellent profit results for June and July. This is based on the pre-tax profits for June and the average profit margin in June of 3.7% of sales and the median profit margin of 3.8%. Remember the average for the last ten years has approximated 2.4 - 2.5%. The average dealer in this survey sold 67 new vehicles and 93 used vehicles in June and 71 new and 83 used in July. Preliminary numbers for July profits reflect the median (middle) dealer reflected a 4.4% pre-tax profit percentage of sales. Best ever that we have seen.

Ford Motor Company

Two of our Ford dealers that have either sold out this year or will be selling have received an unexpected negative surprise from Ford. These dealers sold Ford service contracts, as Ford, when notified they were selling, told the dealer that Ford would be withholding funds in the selling process for future service contract cancellations. How many Ford dealers know about this or even think about this? The amount for a very small Ford dealer exceeded $50,000 and for a much larger Ford dealer it exceeded $500,000. It is not very negotiable for Ford and they can quit paying the dealer for rebates, holdbacks, incentives, warranty, etc. This causes the selling dealers to receive at closing less in cash than they were planning on. You need to allow for this if you are a Ford dealer that sells Ford service contracts. We are not aware of any other manufacturers that have this policy.

Ford Motor Credit Company (FMCC)

Earlier this year in an email, we wrote about our concern for dealers that had some of their excess funds "on deposit" such as a CMA account with FMCC. We commented about a concern that if FMCC filed for bankruptcy, they have a very low credit rating, these funds could be at "risk." We still have that concern and suggest that all dealers that have a "CMA" account with FMCC, cash in those "CMA" funds and use those funds to pay down their floor plan. We believe this might reduce your risk of losing some of these funds if they file for bankruptcy. If anyone does not accept what we wrote above, feel free to call us to discuss. Also, some dealers that have floor plan with FMCC do not realize that if they leave FMCC and go to another lender, there is a "walk away" penalty fee they will have to pay FMCC to leave. For those dealers, are you aware of this "fee?" It applies to dealers who have been with FMCC for less than four years. You might contact FMCC in writing to find out if this applies to your dealership (we have a copy of the FMCC agreement). Also, you might compare the floor plan rate you are paying compared to other lenders. Feel free to call us anytime to discuss.

"Your present circumstances don't determine where you can go; they merely determine where you start."

Nido Qubein

Inside

Sale and Purchase of Dealerships

As we often write and many in the industry know, the two main negotiable assets being purchased are blue sky/ goodwill and real estate. Typically, Blue Sky will be some multiple of expected profits (not our first choice) or a return on total investment, working capital, furniture, fixtures, equipment (F F &E) and Blue Sky. Real estate is typically based on a valid real estate appraisal though we have seen many real estate appraisals, both very high and very low, that made no sense.

We have seen several recent proposed sales of dealerships where the Blue Sky made sense, and though the fair market value of the real estate might make sense based on appraisal, the value of the real estate was so high that either the Blue Sky value should be reduced or the rent would have to be reduced. Perhaps an example might help to better understand this concept. Usually the rent on a dealership facility approximates 8% of the fair market value and the real estate value would be 13% of the annual sales of the dealership. If a dealership has $50 million of annual sales the estimated real estate value, our rule of thumb, would be 13% of $50 million, or $6.5 million real estate value. The annual rent would be 8% x $6.5 million = $520,000. These metrics match up with the NADA which reported rent and equivalent being 11% of gross which includes property taxes, maintenance, etc. All of this means that when buying a dealership if the real estate value is high based on the store being sold, the knowledgeable buyer needs to reduce their expected profits to allow for excess rent for a dealership this size. Said another way, if the buyer expects to make 2.5% of annual sales with normalized rent and if the real estate price is $1 million higher than normalized (rule of thumb), then annual profits will go down 8% of $1 million or $80,000 per year. If you use the multiple of earning of say 4, then the Blue Sky offer should be reduced by $320,000 ($80,000 excess rent x 4 = $320,000). Many sellers are finding out the asking price of the real estate does not make sense based on the expected annual dollars sales of the selling dealership.

Ford Vehicles

We prepared a short report recently for a Ford dealer. He was being told by some of his employees how “low” his front-end gross profits were in July and earlier compared to other dealers. We hear the same thing at times from other dealers. We had our doubts but thought we would analyze this. We have access to over two hundred new vehicle dealers financials and many are Ford dealers. As of the time of preparing this analysis, we had reviewed 18 new Ford dealers’ financial statements. We found this random group of dealers reflected a new front-end average gross for July of $1,523 and the median (middle) dealer reflected $1,513. For July year-to-date the new average was $1,552 and the median (middle) dealer reflected $1,536. These actual front-end gross differ greatly from what some dealers are hearing from their employees. Be careful when you are listening to your employees about competing dealers selling new vehicles for very low front-end gross.

General Motors (GM)

GM has a monthly one-page report named Dealer Performance Summary also known as the “DART” report. It has four main metrics on it: new vehicle sales effectiveness, customer satisfaction, capital standard (meeting GM working capital guideline) and net profit as a percentage of sales. GM has assigned a base score of these four metrics: 50, 30, 10, 10 = 100. In the past GM would score each of these four metrics and dealers could receive a lower or higher value based on how well they did. You could argue the weighting of these four metrics, but there was some basis for the scoring from 50-10. However, GM has now changed this scoring to where some would call it “corrupt.” What do we mean? The metric on new vehicle sales is the same as the past with the base being 50, but it can both go up or down based on performance as in the past. The same holds true for customer satisfaction. However, on the working capital metric and profit metric it cannot go up from 10 no matter how good the dealership performs. In other words, if you are below average you are penalized, but if you are above average you do not get any credit. This does not reflect well on GM. Also, the overall score, if it is below 100, dealers need to work to get it close to 100 or GM can and will use it against you. Some are of aware of this “flawed” scoring system including GM dealers along with a few industry experts and others.

Dealership Rent and Equivalent

Some factories and the NADA report a metric called: RENT AND EQUIVALENT. What does this mean? Typically, this means rent, amortization of leasehold improvements, depreciation of owned facility, property taxes, building insurance, maintenance, mortgage interest, and utilities. We recently analyzed a representative group of our dealers to try and measure RENT AND EQUIVALENT. We found RENT AND EQUIVALENT to be 9 – 10% of total dealership gross profit while the NADA reports 11% (12/31/2019). We also found the metric of just RENT to approximate 65% of the total of RENT AND EQUIVALENT.

Hyundai

Hyundai sent out a Dealer Network Development Memo August 20, 2020.

It discusses their new planning guides and updates to its net working capital and floor requirements. It is important to carefully review all factory correspondence (read prior article on General Motors). Hyundai discussed their expected future toward a goal of 1 million in sales. They report selling 690,000 new units in 2019. To obtain the 1 million in unit sales they need to increase unit sales by 45%. This seems very optimistic. Also, they discuss in their memo that a New Vehicle Planning Guide is being calculated. It is important for Hyundai dealers to make sure their assigned planning volume is reasonable both from an availability standpoint and from a competitive perspective. Do not ignore this for it can cost you rebates and incentives and possibly keep you from buying additional dealerships.

Internal Revenue Service (IRS)

We are recently finding many issues with the IRS. It appears they were not open for business for many weeks and they are way behind in recording and acting on tax returns and processing correspondence. If you receive any notices from them, probably for the remainder of the year, respond to their notice just assuming they have not processed what they are writing about or send them a copy of what they are writing about assuming they have “lost” it.

This includes payment checks they have not cashed. In this case, tell them you mailed the check timely. Either offer to stop payment on the check they lost or issue a replacement check.