Steering your dealership
to higher profits

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Pre-tax profits for dealers through December 2021 were the best ever. There are two reasons for this, one reason is that, after a review of over 250 new vehicle dealerships through December 31, 2021 pre-tax profit margins were in the 5% range of sales. From 2010 to 2019 this percentage was approximately 2.5%. In other words, dealers pre-tax profit margins and pre-tax profits were about double in 2021 compared to the last ten years. The second reason is, the month of December 2021 pre-tax profits are most likely the best ever due to the huge LIFO recapture from new vehicle inventories. These LIFO profits reflect on the December 31, 2021 new vehicle dealership pre-tax profit results. These huge LIFO profits exist because the end of year new vehicle inventories are down so much that it caused substantial reduction in the year end reserves. As we understand it, there is still a possibility, though probably remote, of the federal government allowing dealers and other industries with LIFO inventory a "work around" to diminish the effects of LIFO inventory profits for 2021. The IRS and US Treasury have the authority to do this should they choose to do so.

Dealership's Transition

Many dealers as they get older or become tired of the car business think about selling their dealership. We often point out that maybe instead of selling the dealership, this potential selling dealer should find a general manager to run the dealership and let this person have some ownership percentage, say 5-10%. We hear at times this dealer believes they are so good they do not think they can find a qualified general manager. We point out, even for below average performing existing dealers, that maybe having a general manager that only operates the dealership at 80% of the profitability of existing dealer, they might be better off keeping the dealership than selling the dealership. If they sell, most likely they will only earn a low safe return on the after-tax invested cash from a sale. We usually suggest they offer this general manager a 5-10% ownership opportunity to start with. Even if this investing general manager person does not have any cash to invest, you call sell them 10%, with a note payable over a few years. They can use their 10% share of the profits to make the payments. Once they have been paid for the first 10%, the selling dealer can then sell another 10%. In this example, we suggest the 10% is valued at current value tangible net worth, no blue sky, at this time. If all the profits are paid out, then the purchase amount in the future will not change very much. At some point in the future, the selling dealer can then start charging the general manager for the blue sky when they are more apt to be able to pay for blue sky. If you pick a reasonably effective general manager, you will earn more at the dealership than selling out, paying income taxes, and then "safely" investing the remainder.

"It always seems *impossible* until it's *done*."

- Nelson Mandela

Inside

2022 Calendar Year

Our advice to dealers based on 2021 new and used retail volume and gross profit margins, is for those dealers that made 5.0% + pre-tax profit on sales, is to keep doing the same thing you did in 2021 selling new and used. Keep "overpaying" for used vehicles as long as you ask enough and are making good front-end used retail gross profit margins. Raise the hourly wages of the lower paid employees to keep them from leaving for fast food restaurants to earn $15 per hour or a similar amount. In other words, maintain status quo until the industry shows it is going back to the days of 2019 and before. If you are making less than 5.0% pre-tax profits on sales, you need to meet with some of your dealer friends and find out why you are missing this profit wave.

Working Capital Guideline and Actual

As we know, each factory has its own calculation of working capital for each of its dealers. The general definition of working capital is current assets less current liabilities. The LIFO reserve might be added back to the current assets if it is shown as a negative inventory amount in the current assets. Though some formulas differ slightly, the end result for dealers is often similar. We surveyed 100 dealers at the end of November 2021, and determined their assigned working capital guideline, annualized dollar sales, along with their actual working capital. Overall, for all franchises, we found the median (middle) factory working capital guideline to approximate 3.5% of annualized total dollar sales for a new vehicle dealership.

Of the sample of 100 new vehicle dealerships, we only found 2 dealers that were below their factory working capital guideline. These excellent working capital guideline results could be explained based on the "double" pre-tax profits most dealers made in 2021. The median of all dealers in the survey reflected working capital as a percentage of annualized sales to be 9.6% versus the guideline of 2.9%. The median dealer reflected 9.9% of annualized sales for their working capital guideline.

Nationwide New Vehicle Sales (Cars and Light Duty Trucks)

As reported by Automotive News, total new unit sales in 2021 were 15,060,000 while total new units sales in 2020 were less at 14,575,000. Toyotas' total new unit sales took the lead over G.M., Toyota sold 2,028,000; Ford sold 1,805,000; Chevrolet sold 1,422,000; Honda sold 1,309,000; and Nissan sold 919,000. The franchises with the largest percentage decline in 2021: Chevrolet 17.7%; GMC 6.4%; Dodge 19.3%; Cadillac 8.6%; Lincoln 17.5%; Infiniti 26.4%; and Jaguar 21.9%.

New Vehicle Sales Effectiveness

Many dealers might think we are "jumping the gun" to be bringing up new vehicle sales effectiveness with the new vehicle inventory shortages in existence for much of 2020 and almost all of 2021, if not all of 2021. If your score is well below 90%, you might consider the following:

Why is it below 90%?

Is it my fault? Find out.

Is the factory scoring methodology "flawed"? (At times, it can be).

How often have we written the factory in the last 3 years, phone calls basically do not count, requesting more balanced inventory? These writings can be used to your benefit in the future.

Early 2022 might be the time to work on the above if you qualify.

Advertising

We took a reasonable sample of over 200 new vehicle dealers November y-t-d financial results to report on gross (before manufacturer rebates) advertising expense. We expected vehicle advertising to be less than in the past, much diminished new and used vehicle inventory, both on a per retail vehicles sold basis and on a percentage of vehicle gross profit. The average dealer of this group made pre-tax net profit of 5.8% of sales while the median (middle) for this group was 5.7%. We found gross new vehicle advertising per new unit sold to approximate $380. We found Chrysler dealers amount to be $488, Ford dealers $455, GM dealers $323, and Import dealers $299. The largest amount new for Chrysler was $775, for Ford $650, for G.M. was $531, and Import was $468. We found gross used vehicle advertising per used unit sold to be approximate $208. For Chrysler dealers the amount was $184, Ford dealers $284, GM dealers $161, and Import dealers were $234. These amounts were from dealers that on average had a November y-t-d pre-tax net profit percentage of sales of 5.7%.