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DEALER INSIGHTS

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Dealer Digest

The balance sheet — a critical management tool

When your dealership's financial statements arrive at your desk, is the income statement the first thing you examine? If so, you're not alone — all business owners want to see that the money coming in is exceeding the money going out. But, although important, your income statement isn't the best indicator of your dealership's financial health. For that knowledge, you must turn to your balance sheet.

Assess your equity

Your balance sheet is a statement of what your dealership *owns* and what it *owes* at a particular point in time. The difference between your dealership's assets and liabilities is its equity.

Your dealership has two financial goals: to increase its profitability and to increase its equity. Your balance sheet tells you how you're doing on that latter goal — and a lot more.

Review your report card

Your balance sheet is as much of a report card as your income statement is — it just grades you on different aspects of your performance. Let's suppose that John Dealer, owner of fictitious import franchise Suburban Auto, reviews his annual balance sheet ending Dec. 31, 2011. John focuses on several specific indicators of his dealership's financial condition:

Net earnings (profit for the year)	$338,336
Beginning-of-year equity (net worth)	$1,390,901
Total liabilities	$2,481,265
End-of-year equity	$1,729,237
Total current assets	$3,652,590
Total current liabilities	$2,481,265

From the data above, John can create some critical ratios for his dealership, such as its return on equity (ROE). These ratios become even more useful when you start comparing them over several years and pinpoint trends in improvements or declines. The value of the ratios increases further when you compare them to industry statistics.

Determining your ROE

To calculate ROE, take your net earnings and divide that amount by your equity at the beginning of the year. John can see that Suburban Auto had an ROE of 24.3%.

This would be a great return in the stock market, but for a dealership of John's franchise, the benchmark for ROI on a strong-performing operation is around 32.0%. So there's room for improvement.

Calculating your debt-equity ratio

John also can calculate his dealership's *debt-equity ratio*. He knows that too much debt can make his business vulnerable. For example, if his dealership is too leveraged in a downturned economy, it may be unable to withstand years of loss or raise money to reposition itself for better times.

To calculate the debt-equity ratio, take your total liabilities and divide them by your total equity at the end of the year. Suburban Auto's debt-equity ratio is 1.43, which indicates that the dealership is running on an acceptable amount of debt — the lower the ratio the better — and isn't too highly leveraged. The industry average for an import dealership is around 2.30.

Figuring your current ratio

Another measure of safety and liquidity is the *current ratio*: current assets divided by current liabilities. "Current" assets are cash and assets that are expected to become cash within 12 months, and "current" liabilities are those that are due within 12 months. It's crucial that your balance sheet show more items *converting* to cash than items *requiring* cash in the coming year, so your current ratio should be, at minimum, more than 1.0 — but higher is better.

Suburban Auto's current ratio is 1.47, which indicates that it has more than enough assets to cover its short-term liabilities. The industry average is around 1.50. A lower ratio raises the concern that, if the dealership can't get financing, it will be unable to meet its current debt obligations.

Where's the money?

The big-picture insights your balance sheet can provide are invaluable in the long haul. But smaller puzzle pieces tell you where your dealership's money is going now.

Watch out for round numbers

There are times when dealership owners need to question what they see on the balance sheet. On its year end statement, fictitious dealership Suburban Auto, for example, has an $11,000 line item for "nonautomotive inventory." It isn't clear what this item is, and the owner shouldn't accept round-number entries without asking for an explanation from Accounting. Rounded numbers can be a red flag for unsubstantiated estimates, underreported expense or fraud.

To help catch errors and possible fraud, your dealership's balance sheet accounts should be reconciled regularly. As an outside party, your CPA is in a good position to perform this service.

For example, the Used Vehicle Memo section of Suburban Auto's balance sheet shows that 34 used, franchise-brand vehicles (valued at $508,444) and 52 used non-franchise-brand vehicles (valued at $688,036) were in inventory over 30 days, tying up nearly $1.2 million in cash.

Studies have shown that used vehicles over 30 days cost a dealership more than merely the interest it pays to the bank. Such costs include the wages of those who maintain the inactive vehicles' appearance and operating condition and "spiffing" costs to your salespeople to move the older units. Plus, these slow movers typically produce a lower gross profit than would a fresh vehicle.

More missing money can be found under "Receivables Analysis." Suburban Auto's customers owed the dealership $93,654 in outstanding payments for vehicles and $18,085 in outstanding payments for service, body shop and parts invoices. That's roughly $112,000 that could be working for the dealership, but isn't.

What's *this* about?

The balance sheet also can raise questions. On its right side, Suburban Auto's statement shows monthly profits ranging from a high of $45,549 in March to a low in-the-black figure of $16,488 in October and a *loss* of $3,502 in November. Why did the dealership lose money in that one month? John should already know the answer, but he might need to analyze the details to prevent a reoccurrence.

Sometimes the questions are tax-related. Under "Total Current Assets," for instance, Suburban Auto values parts equipment at $240,682 and signage at $6,966. It appears that no depreciation is being taken on this equipment because there are no values in the corresponding "Accumulated Depreciation" section. Why aren't these items being depreciated? This could signal missed opportunities for tax deductions.

A monitoring device

The analysis of the balance sheet is only one of many tools at your disposal to manage your dealership. No one tool is going to be a complete solution. But, by using these tools in harmony, along with trending and industry benchmarks, you can keep a fine pulse on your dealership and know when trouble is beginning to brew. ■

Don't let unwanted stock get the best of your store

Which new cars sell quickly in your market depends on your customers' demographics and various vehicles' popularity at the moment. To avoid letting slow-moving vehicles have a negative impact on your dealership, you need to keep your eye on the prize.

Happy customers matter

Begin at the beginning: Take steps to get the vehicles you want from your manufacturer instead of units that will tie up your working capital and accrue interest as you await a sale.

The truth is that more-desirable inventory often goes to dealerships with high customer satisfaction index (CSI) scores. Runners-up must make do with a less desirable model mix. Thus, maintaining high CSI scores can go at least part of the way toward avoiding the problem of unwanted stock.

Location counts

Sometimes geography is the issue. What may be a slow seller in your territory could be a hot item elsewhere. For instance, imagine a convertible that arrives in the middle of a New England winter. Parked next to a snowbank, it may not sell until summer. But it might find a buyer more quickly in sunny California.

Consider working with another dealer in a different part of the country. You never know — a one-time arrangement to rid yourself of an unwanted delivery could grow into a long-term, mutually beneficial relationship.

Or you could deal directly with customers in other locations. To this end, the Internet has become key. Many websites have evolved from individual auction forums to outlets for professional retailers.

The factory may have the answer

Another solution for unwanted deliveries may come from the factory itself. Take advantage of any manufacturer programs to use an undesirable vehicle rather than trying to immediately sell it. In some cases, assigning it as a service loaner, rental vehicle, driver education car or the like might lessen your problem.

Interestingly, some models that sell slowly when new are much more popular when used. Extracting some revenue or service from the vehicle before selling it as a used car, truck or van could help cut your losses.

You may even be able to use the vehicle as a showroom traffic builder. Some so-called "halo" vehicles, which are most often sporty and expensive models built to create a favorable image for other models in the manufacturer's lineup, often sell slowly.

Still, many potential customers may be genuinely interested in the vehicle, if only for the uniqueness of its design. Taking advantage of the attention it draws until a paying customer shows up can justify the cost of keeping it around.

No crystal ball

A dealership doesn't always know which models will have quick turn times and which won't. Sometimes, for example, big excitement about a new model fizzles out once the novelty wears off. But if you know your "audience," stay current with area trends and are inventive, you may rarely have reason to return stock or watch a unit age. ■

Estate planning checklist

Timing is everything

One of the essential questions in estate planning is: Who should inherit your assets? The answer can vary during your lifetime, and your challenge is to make sure you stay current with life changes. You'll also need to remain on top of tax law developments that will affect your estate.

Here's a checklist of times when you should review your estate plan and make any necessary changes.

All about family

For most dealership owners, changes in family structure and make-up will have a significant impact on estate planning.

If you're getting remarried (or married for the first time), for example, you'll need to consider how marital rights in your state will affect your assets — that includes your dealership and the land it's on if you own it. Most states have laws to protect the surviving spouse.

Additional restrictions will apply if you live in a community property state.

Here are some other family-related times that call for an estate plan review:

- ❑ Having children in a first or subsequent marriage
- ❑ "Acquiring" stepchildren
- ❑ Adopting children
- ❑ Seeing one of your children get married
- ❑ Having grandchildren
- ❑ Getting divorced

Experiencing a death in the family, including that of a spouse or other beneficiary, of course, would be another key time to revisit your estate plan and make appropriate revisions.

Gift, estate and GST tax changes

	2012	2013
Exemption	$5.12 million	$1 million*
Top rate	35%	55%

** GST tax exemption will be indexed for inflation.*

Tax law changes

Life changes aren't the only times to revisit your estate plan. Sometimes Congress dictates when it's time to consider estate planning moves, and this year is a good example. Currently, an all-time-high gift tax exemption of $5.12 million is in place, but it's scheduled to drop to $1 million in 2013.

So, assuming you haven't already used up part of your exemption on other gifts, if you make gifts up to $5.12 million this year, you won't owe any gift tax on them. Plus, at minimum, the future appreciation on those assets will be removed from your taxable estate. But before making gifts, make sure you can afford to do so; you don't want to risk your own financial well-being.

Here are some other potential tax law changes to keep an eye on:

- ❑ Gift, estate and generation-skipping transfer (GST) tax rate increases (or reductions)
- ❑ Estate and GST tax exemption reductions (or increases)
- ❑ Income tax law changes that could affect your net worth

And in the end

Careful planning with your tax advisor may even allow you to structure an estate plan whereby income-producing assets are kept out of your estate at death while providing an income stream to you during your lifetime. Whatever strategies are part of your estate plan, periodic reviews are essential. ■

DEALER DIGEST

Good things come in small packages

When it comes to customer service, dealerships in large metro areas should emulate dealerships in small towns, a Ford executive recently pointed out. And that's a philosophy that can be applied to dealerships of *any* brand.

"We want the large dealers to step up and do what the small guys do," Jim Farley, Ford's group vice president–global marketing, sales and service, told Lincoln dealers at the recent National Automobile Dealers Association convention. "It's a reversal of sorts because auto makers typically urge small-town dealers to emulate some of the things metro dealers do."

Consider whether your dealership gives customers the kind of personal touch they'd receive in Small Town, USA. From how salespeople handle customers in the showroom to how service technicians explain repair work, small town values — such as honesty, friendliness and concern — have merit in any locale. ■

What counts in lead management?

The number of online sales leads your dealership will receive this year could jump by as much as 15% to 20% over 2011, according to the latest *Automotive Franchise Activity Report* from retail consultants Urban Science. The average dealer might expect leads to rise from 75 to 85 per brand per month.

With the volume of leads expected to swell, it's a good time to refresh your memory about how to effectively manage online leads. Urban Science suggests these best practices:

- ❏ Respond to online inquiries quickly — in less than one hour — and supply a price quote on the vehicle the customer inquired about,
- ❏ Confirm that the vehicle requested is available in a range of offerings,
- ❏ Give the customer information on alternative vehicles in a similar price range, and
- ❏ Offer the customer the next steps in the shopping process, such as coming in for a test drive.

Urban Science estimates that as much as 30% of OEM retail sales originate from online leads. With that track record, it pays to keep your eyes on lead follow-up. ■

Used-car market share up for dealers

Sales of used vehicles by dealerships outpaced used vehicle sales by private parties in 2011, according to Manheim Consulting's recently released *Used Car Market Report*. Franchised dealers sold slightly more than 13.8 million units, an 8% climb over 2010, and independent dealers sold slightly less than that amount, enjoying a 6% increase. During the same period, private party sales climbed only 1%, to 11.2 million units.

Manheim attributed the dealership gain in market share to the "top dollars" offered by dealers for used cars and to dealership financing opportunities. ■