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DEALER INSIGHTS

Two's company?

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Dealer Digest

Two's company?

There's plenty to consider before buying a second franchise

Joel wasn't looking to expand his business when an opportunity arose: A franchise in his area — with a brand he admired — had come up for sale. The previous owner was losing money, but Joel thought he could turn the dealership around. New car sales were strong, and financing was attractive. Should this motivated entrepreneur buy the business?

Purchasing a second franchise is one of the biggest moves a dealer may ever make. Here are some key steps to take in the decision-making process.

Choose the right franchise

Is the brand you're eyeing likely to sell in your market? Just because you've always liked, say, Lincolns — and several customers have expressed interest — doesn't mean they'll sell well for you. Base your decision on solid data, not instincts. Consider whether the franchise is high-quality, is on the rise and matches up with your area's demographics.

The manufacturer can provide sales projections and even assist in (and possibly pay for) market research. Don't stop there: Seek hard data, including the failure rate, from objective third parties. Some financial analysts track auto manufacturer franchises, and your Dealer 20 Group may have additional information.

Determine if the price is right

The franchise's price will probably be the deal maker or the deal breaker. As you evaluate the price, account for your short- and longer-term costs, including:

- ❑ Altering or expanding your store, or building a new facility (see "What the manufacturer may require" on page 3),
- ❑ Adding to your sales force and back-end staff, and
- ❑ Training staff on the new brand and manufacturer's procedures.

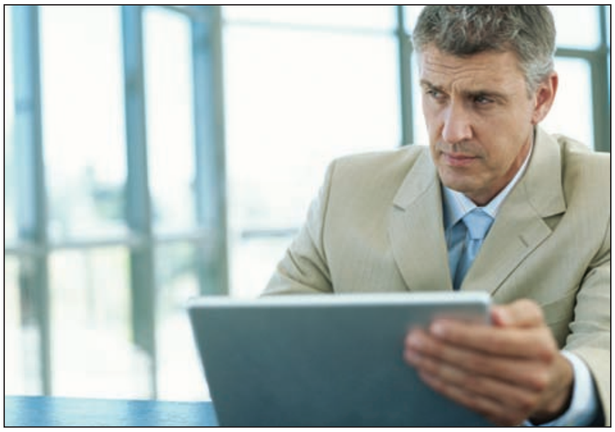
One word of warning: A new franchise normally will operate under working capital constraints. Don't get strapped with too much debt service as a result of overspending.

Additionally, *what* is being purchased matters — that is, assets or stock. Future federal tax expenses are a crucial consideration. Asset purchases are more common for dealerships and can favor the purchaser because costs can be recaptured more quickly through depreciation.

But the seller may prefer a stock sale because the tax paid on the gain often is levied at a lower rate. That means the seller may be willing to accept a lower price for a stock deal. For the buyer, this might make up for missing out on an asset sale's depreciation advantages — but the buyer needs to be concerned about future unknown liabilities that could arise with a stock purchase.

Project profitability carefully

You should be able to find out the current franchise owner's record of profits — or



What the manufacturer may require

When considering a second franchise, take a close look at what the manufacturer will require. Is your *existing* manufacturer offering the franchise? If so, it might allow you to stay in the same facility but require you to build a separate showroom or segregate your showroom area for the two brands.

Some dealerships solve the dual franchise problem by hiring a receptionist to direct customers to separate showrooms and service areas.

If your manufacturer thinks you lack sufficient space, it may require you to open a second facility. It also might require you to dedicate one or more salespeople to the additional franchise and try to make changes to your current sales and service agreement that you might find harmful.

If the second franchise represents a different manufacturer, the plot thickens. The second manufacturer — or your existing factory — may have a long list of requirements that necessitate opening a new facility and running the new franchise separately.

losses — fairly easily. But bring your CPA into the analysis to help identify any hidden losses or exaggerated profits. Annual losses, however, aren't as much of a yardstick as you'd think, because the business likely will be run very differently under your ownership.

What *is* extremely important to consider is the franchise's purchase price, the value of its goodwill and the potential sales volume. Is there enough opportunity for change in the business's operations to achieve the profitability you're projecting?

Assess the impact on your first franchise

If the second franchise is a standalone business, its profits and losses will be calculated separately from those of your first franchise. But if you're putting both franchises together in the same corporate structure, you'll need to assess whether the newcomer franchise will add value and profitability to your existing business.

Or will the second franchise rob your first franchise of sales? Be sure to estimate the retail impact of this "in-house" competitor carefully.

Bring in an expert

Your CPA can be a crucial peg in your decision to add a franchise. He or she can assist in:

- ❏ Determining whether the franchise price is fair,
- ❏ Performing due diligence to authenticate that what you'll receive is what's being represented, and
- ❏ Conducting a sound business evaluation of all the factors mentioned above to determine whether the second franchise is a good idea or a bad one.

Last but not least, your CPA can assist in the submission of paperwork to the manufacturer for the approval of the sales and service agreement.

Opportunities — and risks

Adding a second franchise is a way for a capable entrepreneur to take advantage of market opportunities and expand his or her business. Just remember that a second franchise carries just as much risk as any other investment, and you'll need a proven business strategy to make it all work. ■

Determine the right size for your sales staff

New car sales are ringing in strong this year, with no signs of retreating soon. As many as 14.5 million units are expected to be sold by year end, according to LMC Automotive, which forecasts for J.D. Power and Associates. Industry forecasters see pent-up consumer demand as a leading reason for the brisk sales activity.

If your part of the country is echoing these strong trends, you may be considering a sales staff expansion. But how do you know the right size for your store?

Gross profit per employee

To reach your optimal sales staffing level, there are a number of steps you can take. A good place to start is your monthly gross profit per employee.

Be careful not to hire at a rate faster than your sales and gross are increasing.

A rule of thumb is that each employee should generate gross profit of at least $7,200 per month. To determine your average, take your December year-to-date gross profit and divide by 12. Then divide the result by your current number of sales employees. Does the average fall above $7,200? If so, you may be able to afford to hire more sales staff.

Depending on your circumstances, a $7,200 average may not be right for your business. Always compare your dealership to the market in which you're operating — consider

checking with manufacturer or group composites to see how your average stacks up.

Planning for the peaks

Reaching your optimal sales staffing level isn't a black-and-white matter. To customize your approach, you'll need to think about the changing shades of gray at your operation. Consider, for example, how you handle staffing when sales employees take vacations or call in sick.

Also think about the staffing levels you need for key weekday and weekend hours and for special promotions. Answering these questions will help ensure you have the staffing necessary to handle all your peaks.

Preparing for the valleys

Even in good times, you should have your nose to the future. A question to always keep in the back of your mind is, "Would our dealership survive a decrease in traffic?"

You must continue to work at keeping the number of sales employees in line with sales so that, if the market turns down, you'll be better able to stay on an even keel. If you already monitor your traffic and keep tabs on trends, you're ahead of the game.

Financial problems that arise from carrying too many sales employees can creep up on you. Be careful not to hire at a rate faster than your sales and gross are increasing. Continually adjust your headcount to match your sales, and you'll have a better chance of maintaining your dealership's profits during challenging periods.

Seize the day, cautiously

In addition to a pent-up consumer demand for new cars, other factors point to vibrant car sales, including a desire for more fuel-efficient models, a more relaxed financing environment, and new, exciting models from the manufacturers. Make sure your sales force is staffed up for opportunities, but don't lose sight of risks. ■

Breaking even for profit

When you hear the phrase "break even," you might think, "That's the last thing I want for my dealership — we're here to make a profit!"

True. But calculating your store's breakeven point — and learning the real cost of doing business — can help you profit from better budgeting and planning.

What is the breakeven point?

"Breakeven" can be explained in a few different ways. It's the point at which your total sales are equal to your total expenses. It's the minimum revenue volume your dealership must generate to avoid a loss. It's where net income is equal to zero and sales are equal to variable costs plus fixed costs.

To calculate your breakeven point, you need to understand a few terms:

Fixed expense. These are the expenses that remain relatively unchanged with changes in your business volume. *Examples:* Property taxes, salaries, insurance and depreciation.

Variable/semifixed expense. Your store's sales volume determines the ebb and flow of these expenses. If you had no sales revenue, you'd have no variable expenses and your semifixed expenses would be lower. *Examples:* Commissions and new-car delivery, policy work, supplies, advertising and training.

Contribution margin. You can determine this margin by calculating the difference between revenue and the variable expenses associated with that particular income. *Example:* Gross profit less any sales commission.

How do you calculate it?

The breakeven point isn't complicated to calculate, but you'll need some key data about your dealership: breakeven = fixed expenses / 1 – (variable expenses / sales).

Let's look at an example based on the following annual figures for a store:

Sales	$ 12,000,000
Fixed expenses	$ 912,000
Variable expenses	$ 10,800,000
Contribution margin	$ 1,200,000

Annual breakeven = $912,000 / 1 – ($10,800,000 / $12,000,000)

= $912,000 / 1 – 0.9

= $912,000 / 0.1

= $9,120,000

Monthly breakeven = $9,120,000 / 12

= $760,000

The denominator is actually the contribution margin percentage of 10% ($1,200,000 / $12,000,000). So, you can simplify the breakeven calculation to: breakeven = fixed expenses / contribution margin %.

As long as your expenses stay within budget, your breakeven point will stay reliable. In the above example, variable expenses must remain at 90% of revenue and fixed expenses must stay at $912,000. If you change either of these variables, your breakeven point will change.

What else can it tell you?

Breakeven analysis also can tell you the amount of sales you need to recoup an investment. Let's say that your dealership has been performing a lot of custom jobs for customers. Your service manager sees an opportunity for custom exhaust work and wants to purchase a machine that can bend stainless steel to create custom exhaust systems.

Let's assume the machine costs $10,000 (the fixed cost), and variable costs (labor, materials and commissions) for custom exhaust work are $60 for every $100 of revenue. The annual sales of custom exhaust systems needed to break even on the new equipment would be $25,000:

Breakeven = $10,000 / 1 – ($60 / $100)

= $10,000 / 1 – 0.6

= $10,000 / 0.4

= $25,000

Can it help gauge the effects of cost reductions?

Yes! Assume the same figures from the first example above, except that you have an opportunity to reduce fixed computer system costs by $25,000 per year:

Breakeven = ($912,000 – $25,000) / 1 – ($10,800,000 / $12,000,000)

= $887,000 / 1 – 0.9

= $887,000 / 0.1

= $8,870,000

Prior breakeven point	$ 9,120,000
With cost reduction	$ 8,870,000
Reduction in sales to break even	$ 250,000

In this example, a fixed cost reduction of $25,000 decreases by $250,000 the amount of sales your dealership needs to break even. Such a cost savings could be a real boost in a slow-sales year. Another, easier way of calculating this is by dividing the cost savings by your contribution margin: $25,000 / 10% = $250,000.

Useful management tool

Breakeven analysis is a multipurpose management tool: It allows you to set revenue goals to make any activity in your dealership profitable — and thus, it becomes essential in budgeting. Such analysis also can assist you in planning cost reductions. Your CPA can help you work through the calculations if you need assistance. ■

DEALER DIGEST

Repair costs trending down

The average cost of certain car repairs fell 6% from 2010 to 2011, a recently released study by consumer website CarMD reports. The average cost of an auto repair last year was $333.93 — 21% less than its high in 2006 — according to the study, which examined 163,582 "check engine light"-related auto repairs state by state.

CarMD, which tracks vehicle trouble codes, attributed the repair cost decline to a double-digit drop in labor costs at dealership service departments and repair shops.

The most commonly reported repairs included replacement of oxygen sensors and damaged or loose gas caps. *New* repairs to appear in the top 25 included "inspect battery and charging system and repair as necessary," "replace wheel-speed sensors" and "replace ABS control module."

The four states with the highest car repair costs: Wyoming (average total cost: $389.18), followed by Utah, California and Montana. And the least expensive states for repairs were Indiana (average total cost: $283.95), Maine, Wisconsin and Iowa. Find out how other states ranked on the CarMD website. ■

Statistics we like to know

If business has been rosier at your dealership over the last 18 months or so, you're not alone, according to the recently released *NADA DATA 2012* study. Here are two statistics signaling that 2011 was a good year and, if the momentum continues, this year might even be better:

- ❏ Approximately 41,200 more people were employed at a U.S. franchised dealership in 2011 compared to 2010, and
- ❏ The number of dealerships increased by 66 in the first quarter of 2012.

The study also showed an uptick in new-vehicle sales, creating less reliance on used-car sales. Sales in the new-car department — up 15.6% — topped the 9.8% revenue growth in used cars. ■

Proposal would end collision insurance booklet

A booklet you've been handing out to new-car customers since 1991 would become history if H.R. 5859 becomes law. According to the U.S. House Energy and Commerce Committee, the bipartisan legislation would repeal an "obsolete" mandate requiring motor vehicle insurance cost reporting.

Passage of the bill (which, as of this writing, hasn't been voted on) would eliminate the requirement that the National Highway Traffic Safety Administration (NHTSA) develop information on insurance rates for different makes and models of passenger vehicles. Auto dealers would no longer be required to make the NHTSA booklet, *Relative Collision Insurance Cost Information*, available to prospective buyers or face a $1,000 per violation fine for noncompliance.

Check with your area congressman's office or your dealership association for the latest information on the bill's status. ■