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HEADLIGHTS

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CASH MANAGEMENT

A year and a half ago, it would never have crossed my mind to write this article. I would have written about opportunities to raise more cash. I would have thought we would be advising clients how to survive in this downturn. However, the opposite happened. We are now advising clients what to do with their excess cash and how to manage it in anticipation of a delayed downturn. Thanks to the Paycheck Protection Program (PPP) and a stronger than expected business environment, we are working with dealers on a plan to withstand inventory shortages and ways to take advantage of the situation in which we now find ourselves.

Bart Haag
Albin, Randall & Bennett, CPAs

Many of our clients, depending on their size, are separating their cash reserves into short-term, midterm and long-term needs. We base our plan on filling the following buckets with their cash balances:

✔ **Bucket.0:** The short-term bucket includes cash on hand and other highly liquid cash equivalents, such as savings accounts, etc. These balances generally bear no interest or small amounts of interest and are available for operations.

✔ **Bucket.1:** This is another short-term bucket, which includes cash deposited in floor plan offset accounts and cash used to pay down floor plan balances. The amounts used to pay down actual floor plan balances are usually due to excess funds being available for the offset account. Because the offset accounts are usually a percentage of floor plan, for example, the bank might allow the dealer to "offset" 50% of their floor plan balance in this account. This takes some management because every dollar used to pay down the floor plan balance also reduces the amount available in the offset account. With a little planning, however, these balances are manageable, especially when more than one floor plan source is used. These cash balances earn interest, usually at the floor plan rate, and are highly liquid.

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✔ **Bucket.2:** This midterm bucket generally includes mid- or long-term investments in a brokerage account. With some planning, the owner of these accounts can generally establish a line of credit against the balance, so it is accessible when there is an immediate need for cash. The investments in this account will dictate the amount of cash available through this line of credit, but it can be as high as 90% of the investment balance. The expectation is that these balances will earn a higher rate of return than the balances in Bucket.1. The time horizon for these funds is generally around three years or more.

✔ **Bucket.3:** This long-term bucket includes investments that cannot be liquidated easily. They are usually invested with a minimum time horizon of three to five years, but could be longer, and include investments in private equity funds or other long-term investments.

✔ **Other Bucket:** The other bucket is usually where you would list lines of credit and other investments that will give quick access to cash to take advantage of opportunities or fund capital improvements until more long-term financing can be obtained.

Each of these buckets should include a plan for a target balance and should be monitored on a weekly basis. During a cash management meeting, the participants should come prepared to discuss transitioning from one bucket to the next and managing working capital to ensure manufacturer and bank compliance.

With a plan, dealers should be able to manage their cash and maintain enough cash to take advantage of opportunities and weather any storms created by a shortage of inventory. Contact one of our local AutoCPAGroup members for guidance in setting up a cash management plan for your dealership. ✍

NEW APPROACH TO DEALERSHIP PROFITS

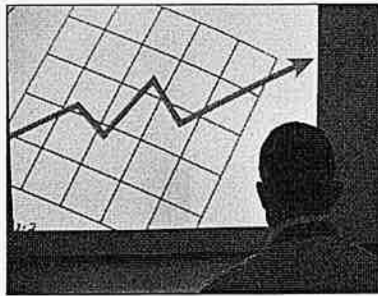
Carl Woodward
Woodward & Associates, Inc.

Dealership pretax net profits as a percentage of sales have been at historically high levels for the three-month period of March to May 2021. In addition to the obvious short-term benefits, this presents an opportunity to re-evaluate dealers' approach to future long-term profits. As reported by NADA, for the 10 years ending in 2019, annual dollar sales averaged $52 million, with pretax net profits as a percentage of sales averaging 2.5%. In 2020, during COVID-19, profit margins increased almost 50%, to 3.6%, and annual sales increased to $59 million. For 2021, sales and profit margins are even better. It is instructive to look at which metrics improved so much to cause profit margins to increase almost 50% for the period May through December 2020 and to double for the period March to May 2021 to more than 5.0%.

What changed? Fewer new vehicles were being sold, fewer used retail vehicles were being sold, fewer new and used vehicles were available to sell, commissions paid to salespeople were reduced on a per-vehicle percentage basis, front-end gross profit increased on sales of new vehicles and used retail vehicles, F&I and service contract income increased on vehicle sales, and advertising and new and used floor plan interest expense decreased. **The results?** When gross profit goes up and expenses go down, there is an increase in pretax net profits. Dealers say they want more new and used inventory. They say this without thinking. If all dealers would think this through, they would come to the following conclusions:

A 45-day supply or less of new units in inventory, not 90 days as many have had the last few years,

would be better for dealership profits and the employees of the dealership. This is reflected today in the lower days' supply and higher new vehicle department net profit.



In the past, most dealers desired to have more new vehicles in stock so they could "maximize" or sell one more new retail vehicle. They were saying this without realizing the benefits that a maximum 45-day supply of new vehicles or less would have on grosses and expenses, as we now see since May 2020. Once the factories are back to over-building the day's supply of new vehicles and "forcing" dealers to take the excess, guess what is going to happen? Fewer new units will be sold, and net profits will go down dramatically.

When dealers realize this, they will require faster completed reconditioning of used vehicles. I have been hearing for many years about the timeliness of getting used vehicles reconditioned. This would have to improve to two days for 90% of used vehicles run through the service department or third-party reconditioning vendors.

What is going to happen when nothing is done? Fewer used units will be sold and net profits will be down dramatically.

We have learned from analyzing the last 13 months that lowering expenses, such as advertising, has a positive effect on the bottom line. To help maintain higher profits, analyze your advertising expense as to where and how much is spent. Many dealers have found that substantially less total advertising is just as effective.

New and used floor plan interest expense will be materially reduced when your days' supply of new and used inventory is limited to 45 days or less. In summary, you might sell fewer new and used vehicles than in the past, but your net profits will go up compared with 2019 and prior years if you learn what has been done the last 13 months.

The current business environment can be instructive for dealers who are open to resetting their approach to profits. Feel free to contact an **AutoCPAGroup** member to assist you in analyzing your metrics and your approach to future profits. ✍

VALUING PARTS INVENTORY IN A BUY-SELL

Jeff Jensen, CPA
Jensen & Associates, P.C.

In a dealership buy-sell, the acquisition of the selling dealer's parts inventory is often an afterthought. Even though this dollar amount may not be the largest portion of the transaction, it is an essential element to most buy-sell agreements. From our perspective, the parts sitting in inventory are just like the owner of the dealership taking dollar bills and stacking them on the shelves. Every part in inventory requires the dealer to invest capital. Buying parts that are not selling is simply giving money away.

We have observed several approaches in buy-sell agreements as to how parts inventory is to be purchased. Most buy-sell agreements state that the parts inventory is to be assessed by a third party, and the result of this inventory is the purchase price. Some agreements will specify what parts are to be included in the purchase price. Some examples of non-returnable parts include parts with containers that have been opened, damaged containers, damaged parts and parts not in the current manufacturer's catalog. Be careful how your

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agreement is written to avoid purchasing old or non-returnable parts. In addition, specify in your agreement the exclusion of parts not in the current manufacturer's catalog. If the dealer has purchased parts from other dealers that are still in the catalog but the manufacturer does not allow you to return parts without the existing dealer listed on the parts being returned, you may have purchased parts that are now non-returnable.

There are many questions that should be asked regarding parts during a buy-sell, such as:

1. Does the manufacturer allow for a special return privilege associated with the buy-sell?

2. Does a special return privilege apply to all parts or just certain types of parts?

3. Does the buyer return the parts, or is the seller responsible to make the return?

This would relate to the time and cost of packing the parts and shipping them to the manufacturer.

4. Does the acquiring dealer retain any of the seller's unused return credit?

5. Is the buyer required to be the returning dealer?

It is necessary for the buyer and seller to agree on these items and to understand the answers. It would also be good to have the understanding with the manufacturer in writing.

It is also essential to know how the selling dealer's inventory system works. Most software systems used in dealerships have management reports for the parts inventory. These reports show the different categories of parts, aging of parts and gross profits realized by the parts department. Understanding whether or not you are buying a reasonable amount and mix of inventory for the dealership to operate is also a key part of the buy-sell process. Many agree that a good metric for number of days' supply is 30 days at dealer's cost.

6. Is the inventory properly aging?

When the management report shows more than 20% of the inventory is at greater than 12 months no sale, you may have a problem.

7. Does the seller's parts department personnel have the ability to change the number of days a part is in stock?

Many headaches can be avoided in an acquisition if attention is given to the parts inventory *before* the deal is closed. Hopefully, the items mentioned will cause some thought to go into this aspect of the transaction. For those dealers not going through a buy-sell, be mindful that there are parts inventory issues that may need to be addressed.

Consult your **AutoCPAGroup** member to discuss this further. ✍

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