

NADA 2008 in San Francisco!

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Moscone Centers --plural here because this convention venue consumes three buildings—a source of confusion for the uninitiated, particularly for map-averse males. It happens to be the site of my inaugural NADA convention ten years ago, and I haven't missed a year since. Driven by my natural curiosity about the business of dealerships, discovering one good idea can easily trump savings from a tax deferral. I even appreciate NADA's free swag (alas, no slide rules this year).

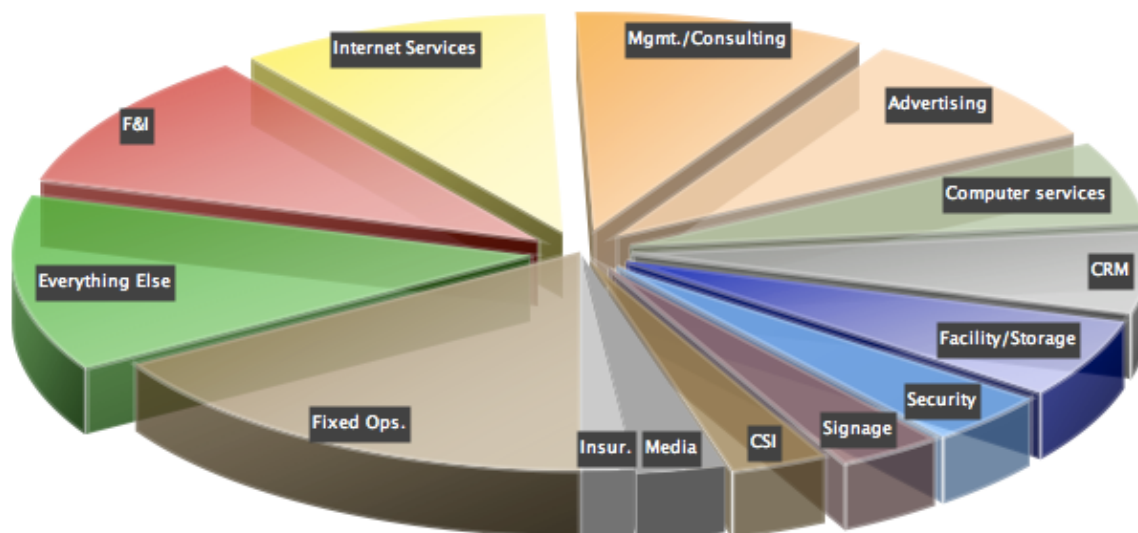
IRS News

IRS had a booth at NADA, but they weren't selling anything except an appeal to dealers for improved tax compliance. IRS has more recently handed dealers a gift with new rules on LIFO inventory. Briefly, IRS now permits one pool for both cars and trucks. Vehicle models that didn't fall neatly into the car or truck classification produced a swirl of confusion in LIFO calculations (is a SUV a car or a truck?). The new rules remove the confusion, simplifying the LIFO calculation (did I just say IRS simplified things?). This is good news because it makes LIFO recapture (i.e. higher taxable income) less likely from inventory level changes.

IRS is also busy preparing new guidance on inventory capitalization. This issue has the potential to alter the amount of tax you pay. But it's not the sort of breaking news you'll see in the scroll during a Larry King interview, so let this serve as fair warning that any goodwill earned from IRS' LIFO news is likely to be short-lived.

Who's Selling?

NADA's footprint seems to grow each year --one could be forgiven for reliving Bill Murray's character in "Groundhog Day," where the vendors fill one aisle, then another, inspiring the "haven't I seen this before" feeling, at least superficially. There were approximately 1,000 booths seeking to lighten dealers' wallets. The pie chart below reveals the composition of vendors at NADA this year, if you doubted the variety.



The exhibition floor's lack of order made targeting a particular product or service difficult. For next year, NADA might consider hiring a parts manager to "bin locate" the vendors: DMS vendors over here, CRM vendors over there, etc. Just a thought, Mr. Brady.

Computer DMS Update

There were no tectonic changes on the DMS landscape to compete with last year's UCS/R&R merger. Dealers are still contending with "The Big Two." That, of course, would be R&R and ADP, vendors that anchor most dealers' data processing expense. Given the "mission-critical" nature of this software, I'm reluctant to recommend "second-tier" vendors without caveats. But this is a matter of timing, as these alternative vendors are becoming more and more viable given the altitude of a five-year DMS contract reaching \$400,000. In an industry that earns 2% net on sales, it can take \$20,000,000 in sales to pay for it. Call me for a complimentary review of your existing contract. Generally, the best route to lower costs is through an experienced negotiator/consultant.

Yes, Microsoft had a booth at NADA. However, we'll have to wait for the vapor to clear before its time to entrust your business to "Version 1.0"

New in the Used Vehicle Department: Get Statistical!

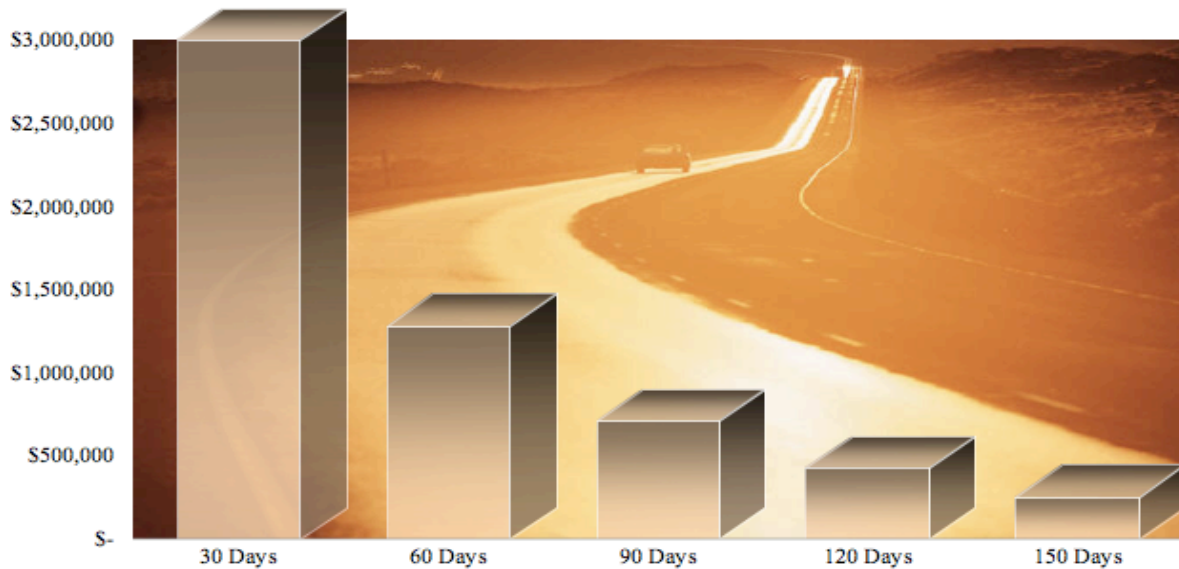
This year marks a watershed for new programs establishing a beachhead within the used vehicle department. Software developers are finally taking cues from the parts department in leveraging the computer to help with inventory purchase, mix, marketing and pricing decisions. At first blush, some of this software appears to be over-engineered, threatening "analysis-paralysis." However, feature-creep is found everywhere, but one only has to use what one finds useful –and there is plenty of utility here.

Does the computer have a role in your used vehicle department? It may be instructive to contrast the management of used vehicle inventory with parts inventory:

Task	Used Vehicles	Parts
Purchase of inventory	Manual	Computer
Measure demand	Manual	Computer
Valuation	Manual	Computer
Days supply	Manual	Computer
Inventory Mix	Manual	Computer
Pricing	Manual	Computer

To be sure, the computer doesn't have all the pieces to the used vehicle puzzle, nor is it expected to supplant the used vehicle manager: the goal of this data is directional. Used vehicle inventory management will continue to require both art and science. People management skills (motivation, training and negotiation expertise) are still the keys to your success, based on my observation powers and dealer financial statements. However, industry observers are convinced that objective data has the potential to transform the used vehicle department.

It's true that parts are more easily treated as a commodity than cars and trucks. However, many buyers are surfing the internet for cars as if they were parts, or commodities, focusing on objective data: Year, Model, Price, and Mileage. (one vendor claims 80% of your customers start at the internet first). The software aims for higher gross profit from useful information that is electronically generated (e.g. what is selling in your market, how competitive your inventory is priced, how effective is your advertising, etc.). It beats hand prepared work, especially if the analysis isn't done at all, given the effort required of a manual process. Below is a graph to illustrate the potential of inventory that turns, a key objective in avoiding aged units, or "lot rot."



Assumptions: Annualized results (e.g. Inventory turning every 30 days is a 12x turn; 60 days is a 6x turn); Average gross profit: \$2,000; Flooring rate 6.5%; Monthly depreciation 1.25%; Avg. used vehicle inventory: \$2,000,000

The main point of this graph is how dramatic gross profit declines as inventory takes longer to turn. The difference between vehicles turning every 60 days vs. 30 days is less than half due to a 50% cut in unit sales and related holding costs (primarily flooring and depreciation costs).

Disraeli, the father of statistics, never ran a dealership. But his contemporaries have made the statistical case that unsold vehicles after 60 days have high probability of remaining unsold after 120 days. It is rare for me to review used vehicle schedules that do not contain aged units exceeding 90 days. Although it's true any vehicle can be retailed, eventually, the downside of slow-moving vehicles and cost of write-downs, spiffs and/or expensive advertising is deceptively significant. However, these costs are often overlooked because current DMS systems are ineffective at tracking intervening write-downs on specific units to accurately report the true gross of an "old maid" in the sales journal. Let's look at an example:

Retail Sales Price	\$14,000
Cost (net of write-downs)	12,500
Reported Gross Profit (per Sales Journal)	1,500
Reported Gross Profit (per Sales Journal)	1,500
Less: Write-Downs	-2,000
Actual Gross Profit (Loss)	-\$500

The sales journal will report a gross of \$1,500, but in fact, the dealership realized a loss of \$500, omitting the relevant fact that there were write-downs during the period it spent languishing on the lot. –not to mention the other carrying costs of flooring, inventory maintenance, etc.

Vendors targeting your used vehicle department include vAuto, AutoTrader, Cars.com, J.D. Power, Penske, and American Auto Exchange ("AAX"), among others. More information is available on the internet about these new tools that are playing a larger role in dealerships today.