



Are They *Too Big* to Fail?

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Are there groups in the Automotive Industry that are too big to fail?
And if so:

1. How do we define who is in that group?

Would the answer be based upon:

- Vehicle sales?
- Dollar sales?
- Dealerships owned?
- Percentage of the market it controls?
- Potential loss of jobs?
- Or, all of the above?

2. Are there warning signs to identify a group about to fail?

It takes work. As I wrote in 2006, **“A dealership is like a dinosaur; you can put a bullet in its brain and it can walk five miles before it knows it’s dead.”**

3. What can be done if and when such a group fails?

I once asked the vice-president of a manufacturer's credit arm why they had pulled the plug on one of their premier dealers. His response was: "We saw him headed to a cliff and we didn't want to go over with him."

But would "pulling the plug" be the answer with today's behemoths?

1. How do we define who is in the group?

"Too Big to Fail" would mean different things to different groups.

In the case of General Motors (GM), President Bush implied his definition was the potential loss of jobs:

I didn't want there to be 21 percent unemployment. . . .I didn't want history to look back and say, "Bush could have done something but chose not to do it." Taken from his speech at the 2012 National Automobile Dealers Association (NADA) meeting.

Also, Politico reported that then president-elect Sen. Barack Obama agreed, stating it was a ". . . necessary step to avoid a collapse in our auto industry that would have devastating consequences for our economy and our workers."

Bush and Obama were supposed to worry about the employees because their duty was to the country and the country could not stand a 21% unemployment rate.

On the other hand, one would presume a manufacturer would be more interested in lost vehicle sales – as that would most affect its bottom line.

Number of dealerships would not matter to factories as much as sales. What would hurt a manufacturer more? – A group with 30

locations that account for 0.5% of its vehicle sales, or a group with 10 locations that account for 1.5% of their vehicle sales?

In over 50 years, I have never known a manufacturer or lender that did not put its interests first, as they rightfully should.

Many dealers do not appreciate the fact that, with the exception of a few local banks, manufacturers and lenders are obligated to protect the interests of their shareholders—not the dealer or the dealer's employees.

Similarly, if a mega-group is going to fail, a group's vehicle sales would appear to be the major concern of the manufacturers because that would affect their cash flow in several ways: Vehicles, Parts, Service Contracts, etc.

In most cases, it would be the lenders who were on the hook for most of the dollars, as manufacturers are paid for their vehicles via their dealer's floor plan financing.

When Chrysler was emerging from its late-1970s financial crisis and Lee Iacocca went on television and announced that all of their newly developed K-cars were already sold, he did not mention that they were sold to the dealers, and not the public.

It was one of the greatest ads of all time. He created a demand based upon a false assumption by the public. And it was legal.

Who Fits the Description Today?

In 2000, the top 100 dealership groups accounted for **15.9% of all new light-vehicle sales** in the United States, a market share that had nearly doubled over the preceding four years.

In 2001, sales of new retail units for the top 100 rose 2.6 percent over 2000 levels.

But, by 2025 five groups, Lithia, AutoNation, Penske, Group 1 and Asbury accounted for 1,485 dealerships, in the U.S. and 2,776,176 new vehicle sales and **the top 100 dealership groups accounted for 30% of all the new vehicle sales in the nation.**

Based upon number of units sold, one of those “top 100” would probably be a good candidate.

2. What are the Warning Signs?

A number of groups brag that all their dealerships average the same Returns on Investment “ROIs” as do individual dealerships.

Well, my daddy told me a long time ago **“Son,if you try to walk across a river with an average depth of two feet, you’ll drown.”**

Remember: **“A dealership is like a dinosaur. You put a bullet in its brain and it will walk 5miles before it knows it’s dead.”**

Today’s Mega-group could probably walk 10miles before it fell.

There is so much cash flow in a dealership, that one could be insolvent long before it becomes obvious to an outsider. In a single store, there are many ways to cover losses – inflate contracts in transit, or prepaid expenses, or paid used vehicle inventories, to name a few.

I have worked with dealerships that were insolvent years before they folded. I once had a top 100 group call me to reveal it had a kite going and was in excess of \$50 million overdrawn at the bank.

Another time the court called me in as a consultant to the receiver of a respected group that was over \$20 million upside-down.

One of the best dinosaur examples came from a deal in Texas. As customary, I had the dealer sit down with the lender's Control Branch Manager to tell him he was \$3 million dollars out of trust. When the CBM asked "How did it happen?" the dealer responded "We had a bad weekend" and promptly left to use the restroom.

The CBM then turned to me and asked: "What did he mean by 'a bad weekend'?" I responded "He meant that they did not sell enough vehicles to cover their float."

In all cases, the factories and the lenders thought the financially troubled dealers were great and their stores profitable. If they did not, they would have handled the problem long before I came along.

But those deals were trifles compared to today's mega-groups, for **today's mega-groups have so many more ways to disguise losses.**

For example, in most groups, each store is a separate corporation.

In one sale in which I was involved, the group had stores in another state with used inventory on their lots for almost a full year. Instead of writing them down and taking the losses, it sold them to the stores they had just purchased, for what they were in them for in the other state and thereby avoided showing losses in the selling stores.

The transactions were legal because no one can tell a corporation what it has to pay for a vehicle. That option is not available to single point dealers.

In another instance a public company was selling a store I could not imagine was profitable, claiming that it was.

When I looked at the financial statements, I saw the store was paying \$5,000 per month rent on a facility that had been sold to them for \$7 million and which was probably worth \$10 million at the time they offered to sell it.

I tried to explain that if someone were to buy it, he would have to pay fair market value for the rent and, assuming he could do no better than them in sales, he would be losing substantial dollars.

Lowering the rent factor increases the profit for every department because each department is allotted its fair share of the rent and, if instead of \$80,000 per month rent (\$960,000 per year, being divided between New, Used, Parts, Service, F&I and Management, only \$60,000 (\$5,000 x 12 months) were divided among the departments; one or more of the departments, standing alone, could turn unprofitable.

The old measures, which both the groups and automotive publications like to tout, such as year-over-year increased vehicle sales and increased profits don't mean much anymore.

Obtaining more vehicle sales and more sales dollars every year is easy – buy more stores.

I worked with a top 100 dealer group that was tens of millions upside down. Every year the principal bought more stores and both vehicle sales and dollar sales increased.

In one instance, when I asked him how he could possibly pay what he did for a Lincoln store, he said they inflated the price and he made a million dollars on the deal.

I explained to him that he didn't MAKE a Million Dollars; he went a Million Dollars deeper in debt.

Unfortunately, there are a lot of **dealers who cannot tell the difference between an earned dollar and a borrowed one** because they can spend them both.

Year-Over-Year increases in revenues, vehicle and parts sales, may be great for egos and pep talks, but are not good barometers of success.

Bill Heard Enterprises, founded in 1919, was the 11th largest dealer group in the United States and the largest Chevrolet dealer in the world when it filed a Chapter 11 Bankruptcy on September 24, 2008, just days after the collapse of Lehman Brothers, which was founded in 1850 and generally considered the 4th largest investment bank in the world.

So much for number one.

Some of the more significant indicators would likely be:

- Has debt to equity increased or decreased year over year?
- How heavily is the group relying on vehicle sales for profit, versus parts and service profits which will sustain them in a down cycle?
- How balanced are their portfolios between hi-lines and blue collar makes? (That would be similar to balancing a stock portfolio.)
- What is their vehicle mix? Electric Vehicle (EV) inventories don't mean as much in North Dakota, or Minnesota, as in California or Florida.

- What do their individual stores net – without things such as subsidized rent - compared to what they netted before the group purchased them. Were they earning \$8 million before and only \$3 million now? Or were they earning \$3 million before and are earning \$8 million now.
- How many losing stores did they sell each year? The answer is an indication of management's judgment in purchases.
- How many profitable stores did they sell? That may tell you about their need for cash.
- Is aggressive expansion leaving the company financially overextended? Opening numerous locations creates logistical challenges and increases overhead costs without guaranteed returns.
- Operating high volume stores requires maintaining a specific number of sales per month, and if sales drop 30 or 40 percent, there's no way you can cut costs fast enough

One would assume answers to those questions would be more relevant than who was #1 in vehicle sales, who was #1 in total sales, or whether their dealerships' average profits equal NADA's stated average.

Assuming one can identify a troubled group, what next?

3. Once Identified, What Action(s) Should / Could be Taken?

Because they always had another dealer in line to run the store when that savant failed, factories have long survived dealers with mediocre business talents and extraordinary operating talents.

While large dealer groups have failed in the past, there has never been a failure of a group with more than 100 stores--and there may be no buyer that could or should take them all.

One would think factories would have prepared a list of potential purchasers of each store, with one dealer or group limited to only one or two stores.

Assuming one was faced with the problem of a giant falling, it would be obvious its stores would have to be sold, but the first thing one must decide is whether or not to keep them open while pending a sale.

In almost all instances, an operating dealership is worth more than a closed dealership, no matter how bad the troubled dealer was.

In the course of over 50 years, I have handled dozens of insolvent and out-of-trust dealerships, with deficits as high as \$30, \$40 and \$50 million and in only two instances were the operations shut down before they were sold.

As anyone who has acquired an open point can attest, an **operating** dealership provides something that isn't sitting on the balance sheet because, for example:

The phone number is already published; cars are lined up in the service drive; parts customers call and walk in; and there are employees who have established relationships with customers.

The buyer has a **foundation upon which to build, instead of having to build a foundation from scratch.**

Every day the doors remain closed, part of that foundation is being carried away by somebody else.

One of the best examples I can give is when I sold a closed dealership to one of the largest and most successful dealers in the area. I warned him that although he may be able to get its vehicle sales going again fairly quickly, it could take up to a year to rebuild the parts and service business.

He disagreed. His name was well known in the area and he spent heavily on advertising. He was confident those customers would come back soon.

About a year later, he stopped by my house to say: **"You were right."**

The problem is that when a dealership closes, its service customers don't stop needing service. They go somewhere else and during the time the store is closed, they develop new relationships with other dealers and independent repair shops.

Advertising may tell them that the dealership has reopened, but it doesn't give them a reason to abandon a relationship that is now working for them.

For a factory or lender dealing with a failing mega-group, keeping the service lanes open may be every bit as important as keeping the showroom open.

Lenders and manufacturers should decide together whether or not a store should remain open while being sold.

Long before a group fails, manufacturers should have compiled a list of candidates with whom they could divide the fallen behemoth.

Back in the late '90s when the idea of public ownership of dealerships was new, I sold a group to a public company.

Before the closing they had rented a theatre for the morning after the closing and invited the managers of all departments, (new, used, parts, service, F&I) to attend a meeting there.

They flew in their number two man to give them all a peptalk about their company and to pump them up about selling cars, etc.

At the end of his talk, I took him aside and, as tactfully as I could, I told him "You know, everything you told them about selling cars is wrong", to which he responded "I'm not interested in selling cars. I'm interested in selling stock."

That was the first time it struck me –

Dealers sell cars; Publics sell stock.

I wonder if anything has changed since then.

John Pico is a retired attorney and founder of Advising Automobile Dealers, LLC and has been consulting with automobile dealers for over fifty years. For more articles about the dealerships and dealers, visit our new website at www.advisingdealers.com

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