

Benchmarking: The Search for Profits and Hidden Cash

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Rex is a principal at HBK and heads up the HBK Dealership Industry Group (DIG) In addition to being a CPA, Rex is also a Certified Valuation Analyst. He began practicing as a CPA in 1984 and, since 1987 has been working exclusively with dealers and their dealerships. Rex's specialty areas include valuations of dealerships; mergers and acquisitions including negotiating financing and due diligence; litigation support services; forensic accounting; economic, operational and management consulting; estate planning; tax research and planning; dealership succession and financial consulting; and dealership accounting, operations and management. He gained dealer industry experience as the CFO of a multi-line dealer group for three years and later as the GM and CFO of a different dealership group. Rex has also owned and operated a Nissan dealership. This actual hands-on experience sets Rex apart from other CPAs. Rex graduated from the University of Indianapolis in 1984 with a Bachelor of Arts degree in accounting and business administration and an Associate of Science degree in computer technology. Over the years he has authored several publications and has spoken nationally at numerous seminars and conferences throughout the U.S. on a variety of topics relating to dealerships. Rex is a current member of the American Institute of Certified Public Accountants, Indiana CPA Society and National Association of Certified Valuation Analysts. He is past-president of the CPA Auto Dealer Consultants Association and currently leads the Dealership Industry Group of the BDO Alliance.

MEASURE EVERYTHING YOU DO

Insanity: Doing the same thing over and over and expecting different results.

Albert Einstein

You cannot improve what you cannot or do not measure.

British Scientist
Lord Kelvin

When we deal in generalities, we will seldom succeed; when we deal in specifics, we will seldom fail. When performance is measured, performance improves; when performance is measured and reported, the rate of improvement accelerates.

Thomas S. Monson

Benchmarking

- Why benchmarking is vital to your dealership?
- Sources of benchmarking information
 - AED's CODB Study
 - 20 Groups
 - Manufacturer's data
 - Other

Some Key Benchmarks

- Gross per employee
 - by department
- Return on Assets
- Return on Equity
- Return on Sales
- Debt to Equity
- Asset Turnover

Gross Profit per Employee

- (a) Gross profit = \$14,186,311
- (b) # of employees = 100

- Gross profit per employee = \$141,863
 - (a) divided by (b)

Return on Assets

- (a) Net income = \$4,142,242
- (b) Total assets = \$38,534,054

- ROA = 11%
 - (a) divided by (b)

Return on Equity

Economic *PROFIT*

“What we call profits, the money left to service equity, is usually not profit at all. Until a business returns a profit that is greater than the cost of capital, it operates at a loss. Never mind that it pays taxes as if it had a genuine profit. The enterprise still returns less to the economy than it devours in resources...Until then it does not create wealth, it destroys it.”

Peter Drucker

Return on Equity

- (a) Net income = \$4,142,242
- (b) Total equity = \$12,928,029

- ROE = 32%
 - (a) divided by (b)

Return on Sales

- (a) Net income = \$4,142,242
- (b) Total sales = \$84,431,995

- Return on Sales = 5%
 - (a) divided by (b)

Debt to Equity

- (a) Total Liabilities = \$25,606,024
- (b) Total Equity = \$12,928,029

- Debt to Equity = 1.98 to 1
 - (a) divided by (b)

Asset Turnover

- (a) Total Sales = \$84,431,995
- (b) Total Assets = \$38,534,054

- Asset Turnover = 2.19 times
 - (a) divided by (b)

Net Working Capital Formula

Total Current Assets
+ Qualified loans to dealership from shareholders
+ Accumulated LIFO write-down (at 60%)
- Total current liabilities & long-term debt

= Net Working Capital

The Concept of Fixed Absorption

The ability of parts, service, and rental operations to produce sufficient gross profit dollars to cover the total overhead expenses of the entire dealership

Fixed Absorption

- Absorption dollars should be foremost in all business plans
- A good target is 115 percent

Absorption Formula

Total parts, service and rental gross profit
divided by
Total operating expenses

= Parts, service and rental absorption

What Drains Service *PROFIT*?

Process failures – poorly designed or design not followed

- Waste, redundancies, bottlenecks, non-value added (dealership and customer), necessary technology, and tools :
 - Shop organization
 - Lot organization
 - Obtaining parts
 - Information flow
- Ideas are presented in order of “ease-to-implement”

How Does Improving RO Cycle Time Improve Service *PROFIT*?

- Reduce waste and turn more work
 - Reduce customer downtime = value to customer, improving their profitability (lower operating costs), and improving customer service and referrals
 - Enabling technicians more time in bay generating service revenue and gross
 - Increase customer base – existing and new

What Drives RO Cycle Time?

- Processes
- Technology
- Measurement

Dealership Cash Management

- Cash management is the key to long-term dealership viability
- Dealerships tend to experience volatile cash balances
- Manufacturers' policies drive cash considerations

Cash Management Policies

- Dealership cash situation should be reviewed with top management daily
- Business operations DOC
- Key accounts

Top Ten Accounts – In Order of Importance (one man's opinion)

1. Used Inventory
2. Parts Inventory
3. Deal Receivables
4. Contracts – In – Transit
5. Accounts Receivable
6. New Inventory
7. Warranty & Policy Receivables
8. Cash Accounts
9. Finance Receivables
10. Other Receivables

1. Used Inventory

- **Accounts to Monitor**
 - Used Inventory Schedules
 - Used Equipment Sales Schedules
 - Advance Trades

- **The Frozen Capital Challenge**
 - Average COS vs. Current Inventory Value
 - Aging Policy – in Days
 - Wholesale Activity

2. Parts Inventory

- **Accounts to Monitor**
 - Parts Physical Inventory Value
 - Parts Accounting Value

- **The Frozen Capital Challenge**
 - Accounting Value vs. Inventory Value
 - Re-order Codes
 - Verifying/Reconciling Inventory
 - Monthly Pad to G/L recon.
 - Core Audits

3. Deal Receivables

- **Accounts to Monitor**
 - Accounts Receivable – Deals

- **The Frozen Capital Challenge**
 - Any Hold Checks?
 - Any Promissory Notes?

4. Contracts-In-Transit

- **Accounts to Monitor**
 - Cash Operating Account
 - Contracts-In-Transit (New and Used)

- **The Frozen Capital Challenge**
 - Average Days Supply
 - Resubmission Time Lapse
 - Ineffective Sales and F&I Management

5. Accounts Receivable

- **Accounts to Monitor**
 - Individual Credit Card Accounts
 - Rental Receivables
 - Parts and Service Customers

- **The Frozen Capital Challenge**
 - Who Authorizes Charge Accounts?
 - Aged Receivable Schedule
 - Rental Contract Terms

6. New Inventory

- **Accounts to Monitor**

- Floor Plan Interest Charges
- Floor Plan Credits Received (interest-free days)

- **The Frozen Capital Challenge**

- Approval of Wholegoods Stock Orders
- Out-of-Trust Conditions
- Pay-off units and “re-floor” via your line of credit.

7. Warranty & Policy Receivables

- **Accounts to Monitor**

- Warranty and Policy Schedule (Aged)
- Warranty Claims Submission Report

- **The Frozen Capital Challenge**

- What is the time lapse between submission and credit acknowledgement?
- Who is responsible for warranty?
- Review Aged W&P Schedule

8. Cash Accounts

- **Accounts to Monitor**
 - Daily Cash Account Balance
 - Bank's Daily Balance

- **The Frozen Capital Challenge**
 - Sweep Accounts
 - Daily Reconciliation of all Bank Accounts

9. Finance Receivables

- **Accounts to Monitor**
 - Individual Finance Source Schedules
 - Charge-back Notification from Lenders
- **The Frozen Capital Challenge**
 - Sources, Schedules and Accountability
 - Income Agreements
 - Review Aged Schedules

10. Other Receivables

- **Accounts to Monitor**
 - Other Receivables Schedule (Aged)
 - **The Frozen Capital Challenge**
 - Review Aged Schedule Monthly
 - Let Bankers Make Employee Loans

Days Supply of Cash

- Days Supply Cash Formula:
 - Net Cash
 - Average Total Expense per Month
 - Customer Deposits and Taxes Payable

Average Monthly Expenses

- YTD Total Expenses, Less
 - YTD Amortization, Leaseholds
 - YTD Depreciation, Buildings and Improvements
 - YTD Depreciation, Equipment
- Total Divided by Number of Months in Statement

Average Monthly Expenses

YTD Total Expenses, Less	894047.00
-YTD Amortization, Leaseholds	4,125
-YTD Depreciation, Buildings and Improvements	21,703
-YTD Depreciation, Equipment	13,741
Total	854,478
Divided by Number of Months in Statement	12
	<hr/> 71,206

Warranty Receivables: Months Supply

YTD Warranty Sales - Mechanical Labor	52,789
YTD Warranty Sales - Parts	41,440
YTD Warranty Sales - Body Shop	7,877
Total Warranty Sales - YTD	102,106
Total Warranty/#Stmt. Mo. = Avg. Mo. Warranty Sales	8,509
Warranty Claims	12,232
Warranty Claims/Avg. Mo. Warranty Sales = Month Supply of Warranty Claims	= 1.4
Times 30 days per month	= 42 days

Inventory Formulas

New / Used Equipment Inventory Days Supply

(A)No. of Used Units	32	
YTD Used Units	200	
divided by		
# of months in YTD	12	
Equals (B) Avg. month unit sales	17	
(A/B) times 30 equals	57	DAYS SUPPLY ON HAND

Ratio Calculation Exercise

- Ratio will measure your actual performance vs. benchmark in locating frozen cash in your organization

The Cash Flow Squeeze - Cost of A Cash Flow Drain

- Accumulated Totals of Cash Flow Drain * from all Calculations

\$



Cost of Cash Drain
(in Capital)

*If Actual is less than Objective, enter "0" on Cash Drain Line

Frozen Cash Challenge

- Review of cash drain
- Measures where we stand
- Follow up monthly on progress



Cash Management Effectiveness

- Average month's total expenses
- Parts, service, rental excess receivables over 30 days
- Excess used inventory
- Excess parts inventory
- Excess new floor plan expense
- Total excess cash (not including cash CIT and finance receivables)

Breakeven Point - New and Used Equip. Sales Needed to Cover Unabsorbed Fixed Overhead

1.	Fixed Overhead Expenses YTD	734,523
2.	Gross Profit Mechanical Department YTD	204,237
3.	Gross Profit Parts Department YTD	134,559
4.	Gross Profit Rental YTD	120,258
5.	Total Fixed Operations Gross Profit	459,054

Breakeven Point -

New and Used Equip. Sales Needed to Cover Unabsorbed Fixed Overhead

(continued)

6.	Unabsorbed Overhead (Net Burden or "NUT")	\$275,469	
	Fixed Overhead Expense - Fixed Operations Gross Profit)		
7.	Average Month Net Burden		22,956 (Unabsorbed Overhead/12)
8.	YTD Gross Profit New Equip/New Unit Sold	1,477	
9.	YTD Variable Selling Expenses New Equip/ New Equip Sold		192
10.	Retained Gross (Variable Net) PNUR YTD	1,285	
	(YTD Gross PNUR - PNUR Variable Selling Expenses YTD)		

Breakeven Point -

New and Used Equip. Sales Needed to Cover Unabsorbed Fixed Overhead (continued)

11.	YTD Used Equip Gross Profit / Used Unit Retailed	1,091
12.	YTD Variable Selling Expenses / Used Unit Retailed	269
13.	Retained Gross (Variable Net) PUUR YTD	822

(YTD Gross Per Used Unit Retailed - YTD PUUR Variable Selling Expenses)

Breakeven Point -

New and Used Equip. Sales Needed to Cover Unabsorbed Fixed Overhead (continued)

- 14. New and Used Gross % of Total Variable Gross
 - % New Gross of Total Variable Gross **77%**
 - % Used Gross of Total Variable Gross **23%**

Breakeven Point -

New and Used Equip. Sales Needed to Cover Unabsorbed Fixed Overhead (continued)

15. Breakeven on New Per Average Month

(Average Month Net Burden X New Gross % of Total Variable Gross Retained Gross PNUR)

$$22,956 \times 77\% / 1,285 = 14$$

16. Breakeven on Used Per Average Month

(Average Month Net Burden X New Gross % of Total Variable Gross Retained Gross PNUR)

$$22,956 \times 23\% / 822 = 6$$

Breakeven Point -

New and Used Equip. Sales Needed to Cover Unabsorbed Fixed Overhead (continued)

14.	New and Used Gross % of Total Variable Gross	
	% New Gross of Total Variable Gross	77%
	% Used Gross of Total Variable Gross	23%
15.	Breakeven on New Per Average Month	14
	(Average Month Net Burden X New Gross % of Total Variable Gross Retained Gross PNVR)	UNITS
16.	Breakeven on Used Per Average Month	6
	(Average Month Net Burden X New Gross % of Total Variable Gross Retained Gross PNVR)	UNITS
17.	Total New and Used Breakeven Points	20
	(Breakeven on New + Breakeven on Used per Avg. Month)	UNITS

Cash Management



Parts Inventory

Aged parts no more than 25% over 90 days

Less than 10% 12 months no sales activity



Used Inventory

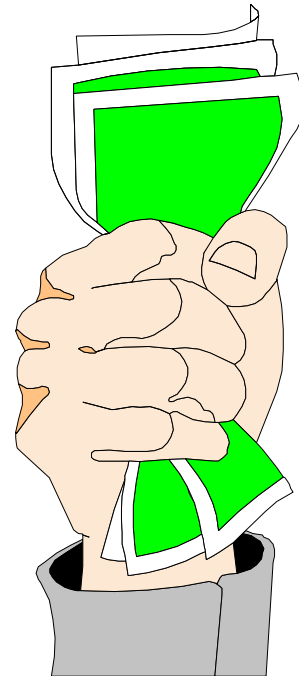
Used units over 60 days old

More than one quarters supply



Deal Receivables

Nothing more than 30 days old



Contracts in Transit

Some experts say 3 days...I look at 5.



Trade Receivables

Should be less than 25% of monthly billings

Aged balances are a problem



New Inventory

60 days supply on the ground (using a rolling three-month average)



Warranty Receivables

Some manufacturers claims are now paid weekly

Accordingly nothing should be older than 7 days (Otherwise, nothing over 30 days)



Cash

Play the float

Sweep accounts



Finance Reserves

Less than 130% of previous month production



Other Receivables

Planes, trains and automobiles

Employee loans

Incentives and rebates



Ad assistance	\$500
Rebate	\$2,000
Volume \$	<u>\$500</u>
	\$3,000

Hidden Cash

New Inventory		4,945,464	
YTD COS	12,317,254		
Month	9		
Average	<hr/> 1,368,584		
Guide	<hr/> 1.5		
		<hr/> 2,052,876	
Excess		2,892,588	
Floorplan Rate		<hr/> 0.09	
		260,333	
Fraction of year		<hr/> 0.75	
Cash Drain			195,250

Hidden Cash

Used Inventory		2,189,141	
YTD COS	13,659,029		
Month	9		
Average	<u>1,517,670</u>		
Guide	<u>1.0</u>		
		<u>1,517,670</u>	
Excess			671,471

Hidden Cash

Parts			298,045	
YTD COS		1,071,514		
Month		9		
Average		<hr/>	119,057	
Guide		2.0		
		<hr/>	238,114	
Excess				59,931

Hidden Cash

• Parts, service and rental receivables		120,695
• YTD Sales	3,554,732	
• Month	<u>9</u>	
• Average	394,970	
• Guide	<u>0.5</u>	
•		<u>197,485</u>
• Excess		(76,790)
• ----- OR -----		
• Parts, service and rental receivables – Past Due		15,025
• Total Receivables	120,695	
• Guide	<u>10%</u>	
• Excess		<u>12,070</u>
• -		2,956

Hidden Cash

Warranty Receivables			28,239	
YTD Sales		500,434		
Month		9		
Average		<hr/>	55,604	
Guide		0.25		
		<hr/>	13,901	
Excess				14,338

Hidden Cash

Contracts in Transit and Deal Receivables		1,349,787	
Current Sales of New and Used	3,720,107		
Days in Month	26		
	<hr/>		
	143,081		
Guide	5		
	<hr/>		
		715,405	
Excess		<hr/>	634,382

Hidden Cash

Finance Reserves		67,710	
Current Production	130,848		
	1.30		
	<hr/>	170,102	
Excess		<hr/>	-102,392

Total Excess

1,399,144

Addback negative items

179,183

Hidden Cash

\$1,578,327

Q&A



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