Chapter 1: Overview of the Auto and RV Dealership Industry

A macro overview of a company's industry and the economy are critical starting points for any valuation analysis. In many cases, the automotive dealer industry trends are better indications of the future than a review of the company's historical operations.

History

Origins

New and used car dealerships were nonexistent until the early twentieth century when car manufacturers became increasingly more efficient with producing automobiles through economies of scale and mass production methods. This paved the way for the idea of selling cars through franchised dealerships.

In the earlier stages of dealership formation, there was a large excess of demand for vehicles over the supply. Dealers were often forced to succumb to the bargaining power of the manufacturer and accept whatever agreement that was proposed. The poor market conditions included everything from manufacturer-established quotas to dealership owners having to pay manufacturers upon delivery of the automobiles.

Development

Auto moguls like Henry Ford and his Ford Dealership Network were the first to push expansion and growth throughout the industry. Because of the enormous popularity of the Model T, Ford opened several thousand new dealerships throughout the country in a short amount of time. He also became the first to require dealerships to stock replacement parts for his cars in order to keep them running at all times, which is now one of the biggest industry standards.

Installment Plans

By the middle of the 1920s, three out of four new car purchases were made on an installment plan. A typical agreement called for a down payment of one-third of the purchase price with the remaining balance to be paid over a 12-month period. In 1925 auto dealers made an estimated $2.5 billion in loans to finance new car purchases. The repossession rate was 2.09 percent.[1] It was also around this same time that trading-in an old car as a down-payment for a new one became a common practice among dealerships. At the end of the 1920's, over 80% of the dealerships in the country included trading-in pre-owned cars as part of their operations. Of course, dealership owners were unhappy with this idea because the profit margin on pre-owned cars was very minimal at the time, especially in comparison to the margin on new vehicles.

In the 1920's, the market finally became saturated and the previous ratio of demand over supply had been reversed. This new surplus of cars was underscored during the Depression Era. Manufacturers became frustrated by the depression woes and began to cancel franchises with the dealers. This forced the dealers to unite and form **The National Automotive Dealers Association (NADA)**. Although weak at the time due to initial difficulties in unionization, NADA is now the largest trade organization in the industry.

1970s to Early 90s

Over 30,000 new car dealerships were operating in the United States by the 1970's. While the number of dealerships in operation had already lessened from the 1950's to the 1960's, things were only getting worse. Domestic manufacturers in the U.S. lost market share to imports, car sales slumped during economic downturns, and dealers trimmed both prices and profits on new car sales in order to unload their inventories. Some dealers were forced into closure while others merged. The consolidation of many dealerships scaled back the total number in operation. By 1982 NADA reported only 25,700 dealers remaining. They included 8,600 small dealers with annual new-unit sales of less than 150, and 3,500 high volume dealers with annual new unit sales in excess of 750. By 1993 the total number of dealerships had diminished further to 22,950. Of these, only 5,300 were small dealers, but the high volume category had grown to 5,700.

1990-2000

By the late 1990s, the auto retail industry had experienced several more consolidations by manufacturers (Daimler-Benz A.G. and Chrysler Corporation and Ford Motor Company's purchase of Volvo Car). By January of 1999, the number of franchised dealers declined to 22,076, indicating that the dealership base was transforming to larger, well-financed companies. The goal for modern dealerships was to reach a high unit volume. Since these dealerships were multi franchised dealers, they tried to increase their opportunity for a sale by putting together different franchises on a single large property.

The arrival of the Internet brought drastic changes to the automobile sales industry. The more successful dealerships in the industry have used the Internet to catalyze large increases in profits and sales. While J.D. Power and Associates surveys showed that third-party websites were the most commonly visited sites by consumers seeking new cars, dealerships and car manufacturers saw a 55% increase of Internet traffic in their sites from 1999-2001.

1. "Automobile Dealers." Encyclopedia of Global Industries. Online Edition. Gale, 2008. Reproduced in Business and Company Resource Center. Farmington Hills, Mich.:Gale Group. 2007. http://galenet.galegroup.com/servlet/BCRC

Industry Overview

A summary of the average dealership profile and sales in each state can be seen in Table 1-1 and in Table 1-2 on page 16.

Table 1-1: Average Dealership Profile

	2001	2002	2003	2004	2005	2006	% change 2005-06
Total dealership sales	$31,670,046	$31,275,581	$32,296,859	$33,009,335	$32,318,461	$31,855,768	(1.4)%
Total dealership gross	$4,154,469	$4,175,456	$4,315,654	$4,363,870	$4,363,870	$4,338,448	(0.6)%
As% of total sales	13.1%	13.4%	13.4%	13.2%	13.3%	13.6%	
Total dealership expense	$3,535,496	$3,576,246	$3,751,511	$3,804,184	$3,776,446	$3,848,964	1.9%
As% of total sales	11.2%	11.4%	11.6%	11.5%	11.7%	12.1%	
Net profit before taxes	$618,794	$615,673	$564,143	$559,686	$531,033	$489,484	(7.8)%
As% of total sales	2.0%	1.9%	1.7%	1.7%	1.6%	1.5%	
Net pretax profit in 1982 dollars	$337,272	$339,027	$306,600	$304,177	$288,605	$266,024	(7.8)%
New-vehicle department sales	$18,808,644	$18,651,091	$19,359,130	$20,116,264	$19,469,000	$18,795,482	(3.5)%
As% of total sales	59.4%	59.6%	59.9%	60.9%	60.2%	59.0%	
Used-vehicle department sales	$9,187,234	$8,942,973	$9,142,647	$9,090,534	$9,067,128	$9,265,366	2.2%
As% of total sales	29.0%	28.6%	26.3%	27.5%	28.1%	29.1%	
Service and parts sales	$3,674,168	$3,681,518	$3,795,081	$3,802,537	$3,782,334	$3,794,920	0.3%
As% of total sales	11.6%	11.8%	11.8%	11.5%	11.7%	11.9%	
New-vehicle average selling price	$25,797	$26,163	$27,565	$28,060	$28,381	$28,451	0.2%
Used-vehicle average selling price	$13,930	$13,840	$13,473	$14,247	$14,923	$15,518	4.0%
Average new worth (as of 12/31)	$2,016,200	$2,230,699	$2,243,589	$2,301,417	$2,258,753	$2,160,181	(4.4)%
Net profit% of net worth	30.7%	27.6%	25.1%	24.3%	23.5%	22.7%	

Source: NADA DATA 2007, pg. 49

As Table 1-1 shows, the average dealership has become less profitable over the years, with net pretax profit experiencing a sharp decline. The biggest driver of this trend is the increase in auto sales over the Internet.

Industry Shapshot

With revenues of approximately $1 trillion per year, the automotive retail industry is the largest retail trade sector in the United States. The majority of automotive retail sales in 2005 were generated by approximately 21,500 U.S. franchised dealerships, producing revenues of approximately $700 billion. The industry is highly fragmented and mostly privately held, with the publicly held automotive retail groups accounting for less than 10% of the total industry revenue.

Of the close to $700 billion in U.S. franchised dealer aggregate annual sales in 2005, new vehicle sales represent approximately 60% and used vehicle sales represent approximately 28%. In addition to new and used vehicles, dealerships offer a wide range of higher-margin products and services, including service and repair work, replacement parts, extended service contracts, and financing and credit insurance, which collectively represent the remaining 12% of total industry revenues.

Table 1-2: 2006 Total Sales By State

State	All Dealerships ($millions)	Average dealership ($thousands)	State	All Dealerships ($millions)	Average dealership ($thousands)
Alabama	$9,887	$28,088	Montana	$2,269	$17,062
Alaska	1,227	30,669	Nebraska	3,423	15,996
Arizona	19,020	74,588	Nevada	7,317	64,186
Arkansas	5,313	19,252	New Hampshire	4,359	25,053
California	86,535	53,384	New Jersey	23,324	39,734
Colorado	10,572	37,892	New Mexico	4,046	29,104
Connecticut	8,437	25,960	New York	31,660	27,507
Delaware	2,101	32,316	North Carolina	19,720	28,334
D.C.	134	66,914	North Dakota	1,504	14,745
Florida	50,083	52,498	Ohio	21,814	22,237
Georgia	20,939	33,991	Oklahoma	15,627	52,617
Hawaii	2,919	44,291	Oregon	7,782	28,095
Idaho	3,223	26,207	Pennsylvania	27,264	22,570
Illinois	25,250	26,193	Rhode Island	2,023	29,743
Indiana	12,261	23,047	South Carolina	8,676	26,290
Iowa	5,949	15,371	South Dakota	1,795	15,080
Kansas	5,449	20,409	Tennessee	12,688	29,644
Kentucky	6,838	22,273	Texas	55,005	40,654
Louisiana	10,933	32,346	Utah	5,671	36,587
Maine	2,964	18,204	Vermont	1,450	14,952
Maryland	13,162	35,572	Virginia	18,210	32,930
Massachusetts	14,358	27,612	Washington	13,372	34,111
Michigan	24,459	31,806	West Virginia	3,174	18,454
Minnesota	11,384	24,965	Wisconsin	10,753	17,599
Mississippi	5,682	23,287	Wyoming	1,325	18,923
Missouri	12,241	24,336			
			Total U.S.	**$675,300**	**$31,854**

Source: NADA DATA 2007, pp. 52

According to industry data, the number of U.S. franchised dealerships has declined from approximately 24,000 in 1990 to approximately 21,500 in 2006. From 1986 to 2007, there has been an overall decline of 14.6%. These trends can be seen in Table 1-3 on page 17. Although significant consolidation has already taken place, the industry today remains highly fragmented, with more than 90% of the U.S. industry's market share remaining in the hands of smaller regional and independent players. It is very probable that further consolidation in the industry would likely be due to the increased capital requirements of dealerships, the limited number of acceptable alternative exit strategies for dealership owners, and the desire of several manufacturers to strengthen their brand identity by consolidating their franchised dealerships.

Table 1-3: Number of U.S. Auto Dealerships from 1986-2007

Year	Number of Dealers	% Change
1986	24,825	
1987	25,150	1.3
1988	25,025	(0.5)
1989	25,000	(1.0)
1990	24,825	(0.7)
1991	24,200	(2.5)
1992	23,500	(2.9)
1993	22,950	(2.3)
1994	22,850	(0.4)
1995	22,800	(0.2)
1996	22,750	(0.2)
1997	22,700	(0.2)
1998	22,600	(0.4)
1999	22,400	(0.9)
2000	22,250	(0.7)
2001	22,150	(0.4)
2002	21,800	(1.5)
2003	21,725	(0.3)
2003	21,725	0.0
2004	21,650	(0.3)
2005	21,640	(0.1)
2006	21,495	(0.7)
2007	21,200	(1.4)
Overall % Change (1986-2007)		(14.6)
Overall % Change (2000-2007)		(4.7)

Source: NADA DATA 2007, pg. 51

New vehicle unit sales are cyclical and, historically, fluctuations have been influenced by factors such as manufacturer incentives, interest rates, fuel prices, unemployment, inflation, weather, the level of personal discretionary spending, credit availability and consumer confidence. However, from a profitability perspective, automotive retailers have historically been less vulnerable than automobile manufacturers to declines in new vehicle sales. Most believe that this may be due to the retailers' more flexible expense structure (a significant portion of the automotive retail industry's costs are variable, relating to sales personnel, advertising and inventory finance costs) and more diversified revenue streams. Additionally, automobile manufacturers may increase dealer incentives when sales are slow, in part to meet production quotas, which further increases