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Outlook for Auto Industry in 2008

As everyone is well aware, 2008 is expected to be another challenging year in the automobile business. Sales of new vehicles are forecasted at lower levels than 2007. This is frustrating since 2007 was extremely difficult for many dealers. Below are several insights about 2008 and how to position yourself for the year to come.

Increasing Market Share - Smaller dealers and those with inferior brands will continue to close. In addition, the manufacturers have recently been offering large termination payments to induce low volume dealers to terminate their franchises. The manufacturers are finally achieving the downsizing that they attempted several years ago. This will accelerate the reduction in dealerships. As everyone knows, the Northeast is "overdealered" and the reduction in stores will allow the surviving dealers to prosper through increased market share.

Reducing Cost Structure - Dealers that are doing well in this economic cycle are running their stores "leaner" than they ever have before. They have adjusted their inventory levels to realistic levels and are paying close attention to their advertising budgets. Dealers are reviewing all expense items searching for cost savings. This needs to continue.

Reduced Interest Rates - Interest rate declines will provide an additional cost savings to surviving dealers. Floorplan rates have declined almost two percentage points in recent months. For a dealer with \$5 million in inventory, this amounts to an annual savings of \$100K.

Improving Used, Service, and Parts Operations - With the exception of a few brands, dealers are experiencing continued declines in the profitability of the new vehicle department. "Grosses" continue to decline. This trend will not reverse any time soon. The success of a dealership will not be measured by the number of new units sold. It will be measured by its ability to sell used vehicles at higher grosses, complemented with a service and parts operation that covers sixty plus percent of the monthly expenses. It will be acceptable to have a new vehicle department that operates at a net loss. The manufacturer will continue to control the gross profit in the new vehicle department and those grosses will continue to shrink. Dealers will need to sell new vehicles to feed the other departments and to maintain a positive relationship with the manufacturer.

In summary, 2008 may be difficult. However, lower interest rates and other expense reductions will allow most dealers to endure this period. Additionally, improved used car operations and a reduction in the dealer network will increase market share for those that do survive. We believe that these factors will position surviving dealers to be extremely profitable when the tide turns and the economy improves.

For more insights on the state of the dealer industry, e-mail Paul McGovern at pmcgovern@downeycocpa.com or call 781.849.3100.

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