



Monthly Automotive Insight

NORTHWOOD UNIVERSITY



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Introduction

As we enter the third month of 2011, the U.S. economy currently is moving in a positive direction as revised 4th quarter GDP for 2010 came in at 3.1%. We are concerned regarding the first half of 2011 based on what higher oil prices and Japanese parts production constraints will do to Spring automobile sales, coupled with the outlook for bipartisan cooperation, the extension of the Bush tax cuts, and a personal savings rate of nearly 6.0%. We continue to be concerned about the mounting U.S. deficit, which is now greater than \$14.2 trillion and the mixed signals being sent from the Congress and The White House as to how to control the size and scope of government spending and the national debt. We are also concerned about the future value of the U.S. dollar with inflation signals being sent by the price of oil, gold, silver and food, as well as CPI data which shows inflation up 2.11% in February.

Key January/February Data

Positive Signs

According to the latest Manufacturing ISM Report on Business, the manufacturing sector of the U.S. economy continued to grow in February as evidenced by the Purchasing Managers index which increased to 61.4%, its highest level since January, 2004. U.S. productivity remains near record levels while cash balances for non-financial based U.S. corporations is at 1.98 trillion dollars. The Dow Jones Industrial Average rose 286 points in the month of February, an increase of 1.5%, while the survey of consumers intending to purchase an automobile over the next 6 months remained positive in February. The February Conference Board Global Leading Economic Indicators report shows U.S. and Europe were positive,

growing at .1% and .5% respectively, while China was negative down .5%. The U.S. savings rate continues at a strong pace, once again realizing a rate of 5.8% in February. Automobile, SUV and light truck vehicle sales were up 21.17% in February 2011, versus January, 2011 and more than 26% versus February, 2010. January and February suggest that inflation is running at an annualized rate of more than 3 percent. The U.S. unemployment rate dropped to 8.9%, down .1% from January, 2011, with private sector employment increasing by 192,000 jobs from January, 2011 to February, 2011. The Conference Board report on consumer confidence showed a substantial increase of more than 5.6% in February.

Negative Signs

While the national unemployment rate made progress in January, falling by .1%, it still stands at a sobering 8.9%. The average 30-year fixed mortgage rate rose from 4.79% in February to 4.86% at the end of February 2011. Gold surged in February and has settled at \$1412 per ounce in early March, while silver increased from its end of February high to close in early March over \$35.00 an ounce. The price movements in mortgage rates and silver, coupled with recent FED policy and the resignation of a key FED board governor gives us further reason to be concerned regarding future inflation. Unemployment benefits remain at record highs and will continue at these levels for at least the next 12 months. The U.S. dollar was mixed against the Euro in February and saw little change against the Yen. Finally, we continue to be concerned over Libya, Japan and the Middle East, as well as the slow resolution of the U.S. mortgage crisis. Sales of new homes hit a 40-year low in February and U.S. corporations are now holding \$1.2 trillion dollars overseas due to the cost of current U.S. tax policy.

Current Issues

Cash Flow and Profits

Successful dealership managers are, by nature, profit-focused. We learn how to mix customers, products and people in the right combination to maximize profit and we hone those skills month after month. Through most of the business cycle the ability to maximize profit is a “money” skill set. But when the business cycle changes direction, the ability to manage cash can become more important than the ability to manage profit.

A dealership that fails to earn a profit in a particular month usually gets a chance to try again next month. A dealership that runs out of cash is out of business. Game over.

Let’s examine a couple myths about cash:

1. I can sell my way out of a cash problem.

Generally not. To understand why not, think of the process of starting a dealership. Before I can sell anything, I invest cash in the store, then convert that cash to inventories. As I sell those inventories, I get some cash back, but I also create receivables (customer, rebates, warranty claims) and new inventories (trade-ins). Those receivables and inventories will eventually convert back to cash as I complete the sales cycle and, if my sales are stable, I eventually recapture my initial cash plus my gross profit (and less my expenses). If my sales rate declines, I can unwind my inventories and receivables, recapture cash and put it in the bank. But growing my sales rate means growing my investment in the non-cash part of the cycle. More inventory. More receivables. Growing my sales rate does not produce cash, it eats cash. While I can’t sell my way out of a cash problem, it’s possible to sell my way into one—a *genuine risk as sales recover from their recent slump*.

2. I can’t make money if I don’t make a profit.

Not necessarily. Operating profit is the difference between gross profit and expense. If my total gross profit last month was \$190,000 and my total expenses were \$200,000, my accountant will record that I lost \$10,000.

But my expenses likely include some depreciation which is a *non-cash* expense. The assets I depreciate today were generally purchased and paid for in the past—I don’t write a check to pay for this month’s depreciation. If my total depreciation (and amortization) in this example was

\$25,000, the remaining *cash expenses* of \$175,000 would have been covered by the \$190,000 gross profit. Some managers use this analysis to get a rough assessment of cash flow and you can see it’s possible for that measure of cash flow to be positive even when profit is negative. When I bring money into the dealership faster than I pay it out, I know I’ve accomplished something important even though I haven’t satisfied an accountant’s definition of profit.

Running a dealership is challenging under any circumstances, but it becomes more so when the checkbook is dictating decisions as much as the managers. Diligent attention the cash implications of your actions can help keep management control where it belongs.

Conclusions

Those interested in more information regarding this publication can contact Dr. Timothy Nash at tnash@northwood.edu or (989) 837-4323. If you know of a student who is interested in earning a bachelor’s degree in Automotive Marketing from Northwood University, please contact the Texas Campus Automotive Program Chair Steve Brazill at (972) 293-5413 or brazills@northwood.edu; the Florida Campus Automotive Program Chair Tim Gilbert at (561) 478-5527 or gilbert@northwood.edu; the Michigan Campus Automotive Program Chair Joe Lescota at (989) 837-4843 or lescota@northwood.edu. For the Automotive Program at Northwood’s Cerritos College in California contact Todd Leutheuser at (562) 467-5252 or leutheus@northwood.edu. If you are interested in online automotive degree programs contact Kim Leach at (989) 837-4840 or leachk@northwood.edu. For information about the Northwood MBA, please contact Matt Bennett at (989) 837-4325 or mbennett@northwood.edu.

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