

Some Dealer Groups at Risk

Lessons can be learned from their potential downfalls

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Select dealer groups that grew aggressively over the last three years are facing potentially devastating challenges in the current economic crisis.

In the coming months, it is likely various large privately owned dealer groups will go out of business, either via bankruptcy, lender seizure or criminal prosecution.

Understanding how and why certain dealers may be at the end of the road can shed some important light on how to avoid potential disaster in the future.

Over the last few years, dealer groups that grew aggressively did so at great expense. In addition to the record-high blue-sky premiums that they paid, they also paid high prices for real estate. Many of them complied with ambitious manufacturer facility plans.

Add to the equation the fact that most of the acquisitions completed in the last few years were lightly capitalized and highly leveraged on the assumption of sustainable growth, and you begin to see the hostile terrain facing high-growth dealers.

Beyond the limits of capital, an additional point of strain for growing dealer groups is the leveraging of human capital.

Dealer groups that grow aggressively typically lack the personnel and infrastructure to properly manage a continuous growth pattern. These challenges are even more daunting when groups grow beyond their immediate market.

Whether fueled by brokers or egos, many dealers convinced themselves and their bankers that their retail skills transcended markets, demographics, franchise, and a crippling debt-service requirement.

There are undoubtedly several large dealer groups that would have already faltered had it not been because their lenders feared the prospect of completely shutting them down.

Many banks fueled the aggressive growth of these dealer groups by providing liberal terms on optimistic projections. Similar to the growth of many banks into the subprime mortgage market, the growth of many dealer portfolios was the result of sometimes careless lending policies.

However, unlike the mortgage market where banks will pursue a foreclosure and liquidation of assets, certain dealer group portfolios cannot be treated in the same fashion, at least not without some significant losses of both capital and personnel at the bank.

As a result, banks will pursue nearly every possible option (including providing additional capital) as an alternative to seizing the operations of a dealership.

Banks are well aware that the possibility of a seized dealership succeeding under their custody is as probable as General Motors reintroducing the Oldsmobile brand.

So, banks will delay the inevitable until the last moment. Given the length and predicted duration of the current recession, it is possible that the last moment for many banks will occur over the next few months.

Since most car dealers are optimists, always believing the coming month will be better than the last, certain decisions are made on the promise of a tomorrow that may never come.

Unfortunately, some of these decisions are made in an effort to buy time until the market turns, and ironically, "time" is what they end up with — time behind bars.

A dealer group can start to get in serious trouble regarding cash flow when it begins to use other peoples cash (obviously without their permission) to maintain operations. Dealers in this position will first begin to falter on their flooring payoff requirements. This problem is followed by lagging on the payoff of customer loans on trade-ins, which is then followed by the delay in payment to vendors, the use of sales tax money and then the final cut: missing payroll.

Missing payroll is usually the knock-out blow for a dealer if the lender or state has not gotten to them first.

In times like this it's important to remember that failure is an element of success — if you can learn from it. Being a dealer can be rewarding, but it's not easy.

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