

Will the Other Shoe Drop?

Beware of chance-of-a-lifetime dealership deals

By Phil Villegas

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While the actions taken by Chrysler and General Motors to reduce their dealer counts are necessary for purely competitive reasons, the costs associated with these actions will extend far beyond those dealerships targeted to be closed.

The U.S. dealer body was suffering from its worst case of attrition in recent memory even before the forced closures were announced.

The known closing of nearly 2,000 Chrysler and GM stores on top of other dealerships that will fail due to the downturn in the economy can bring total dealership closures to more than 3,000 stores over the next 18 months.

At first this would seem like an outstanding opportunity to acquire a dealership, since it appears that things can't get much worse for dealers. But the truth is we are far from a dealership value bottom.

The sudden closing of Chrysler stores, the staggered closing of operations due to economic failure, and the GM shutdowns will likely have a deflationary impact across the industry that will affect all dealers and the value of their dealerships.

These are some of the good and bad effects of deflationary pressure that dealers will feel in the next 18 months:

- **Blue Sky:** Blue Sky will continue to decrease to the lowest levels in 20 years due to the absence of available capital, lending capacity and deterioration of performance.
- **Real Estate:** There will be a continued decline in dealership real estate values due to an oversupply of vacant facilities.

- **New Vehicles:** Overstock of manufacturer inventory along with excess Chrysler and GM vehicles from closures will raise incentives and force other auto makers to compete, driving down prices and gross profits.
- **Used Vehicles:** A flood of vehicles going to auction will drive down the pre-owned market and impact what's left of the leasing market.
- **Personnel:** Over 100,000 direct dealership personnel will be on the market, increasing available talent and reducing compensation expenses.
- **Advertising:** Less competition and spending will cut advertising costs.
- **Outside Vendors:** Vendor deterioration associated with decreased volume and increased competition will lower outside-services costs.
- **Lending:** There will be a decline in capacity as banks pull back as an overreaction to failed dealerships.

As a result of these factors, dealers sitting on the sidelines waiting to go into acquisition mode should continue to wait. It is likely dealership values will not bottom out until the end of this year.

Some acquisitions may make sense. In particular, the following scenarios are worth research and analysis:

- Viable Ford stores in under saturated markets.
- Real estate only — no blue sky, on strategic alignment.
- Franchise only without real estate (short term lease) and with the ability to relocate the franchise, on strategic alignment.

As a buyer, it important to remember that the retail automotive market has the potential to get worse before it starts to get better.

While on the surface, the Chrysler and GM store closures mean more business for everyone else, remaining dealers will continue to have an uphill battle. Many will not survive.

Even if a dealer is able to maintain viability in the coming years as deflationary pressure subsides and the markets begin to ease, it is possible inflation will skyrocket just as we near what looks like a recovery.

Acquisitions in the current market environment are going to require more discipline than ever.

No doubt many dealers will be presented with deals of a lifetime several times before the year is through. In the end, it is always important to remember that if an opportunity appears too good to be true, it probably is.

Phil Villegas is a principal at Dealer Transactional Services LLC in Miami, FL. He can be reached at PV@DTSAUTO.COM or 305-913-7198.