WARD'S Dealer Business

It's a Gamble

By Cliff Banks
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If you're looking for dealerships to buy, stay away from the premium brands such as Toyota, Lexus, Honda or BMW.

That's right. Unless you get lucky, you'll overpay for one of those stores. Of course, it is because those dealerships are the best performing and as a result, are on the top of most dealers' wish lists. But that is no secret if you've spent any time in automotive retail.

“If you do buy one, it might take five years before you make any money on it,” says Aaron Zeigler, part owner of the Harold Zeigler Automotive group in Kalamazoo, MI.

So what to do if you want to grow but realize you need more realistic expectations? Obviously, you want a dealership that is going to be successful, and just maybe, one that sells what becomes the next “hot” brand.

But trying to pick the next hot franchise to invest in is a roll of the dice. And it is unlikely there will be another brand like Toyota whose dealerships sold an average of 1,672 vehicles last year (not counting Scion). That was an increase of 190 units compared with 2005 numbers.

Are there any brands sitting under that premium level that have the makings of being a money maker?

“It's really a ‘return-on-investment’ kind of question,” says Rob Cochran, owner of #1 Cochran Automotive in Monroeville, PA. “We've had great franchises. They worked out well for us because the investment has been more moderate.”

For Cochran, which ranked 79th on the *Ward's Megadealer 100* last year, some of those moderate brands include Saturn, Pontiac, Hummer, Hyundai and Subaru, all of which are performing well for the group.

There are times when investing in a brand or acquiring a franchise may not seem much of a gamble, but often, dealers find themselves wondering how they could have made such a “dumb” bet.

At the beginning of the decade, Mitsubishi appeared to be one of the up and coming brands, and then it fell apart as problems at the parent company almost did the brand in.

Ramsay Gillman, a former National Automobile Dealers Assn. chairman and owner of Houston-based Gillman Companies, was one of the dealers who “gambled” on Mitsubishi, acquiring six franchises. By 2004, Gillman laughingly admitted he wasn't “looking too smart” with that choice. He still has five of them, though.

Mitsubishi still is a shaky brand, but the sales declines have stopped and dealers last year increased their average units sold per store by one.

Two years ago, Chrysler executives met with 164 of the nation's top dealers to show off the brand and woo them into investing in it. Nearly a hundred dealers ponied up the money. Zeigler and his father Harold were both at the initial meeting and subsequently bought one Chrysler Dodge Jeep store and built another one.

Even with Chrysler's recent inventory problems and uncertain future, Zeigler says it was the right choice.

Other dealers, though, are trying to unload their Chrysler-branded franchises, mainly because of the resulting effects of the manufacturer's failed inventory strategy of last year. But they may be stuck with a “bad hand.” According to Sheldon Sandler, founder of Bel Air Partners, a dealership investment firm in New Jersey, “Nobody is buying Chrysler right now.”

Now may be a good time to consider making some investments in new franchises. The market is “frothing right now,” says Ken Gilman, who is retiring in May as Asbury Automotive Group's CEO.

The publicly owned dealership chains, such as his, in recent years have focused their acquisitions on high-end premium and import brands, but are showing interest in some domestic brands. “We're looking at some,” Gilman says.

On the other hand, the strategy for Lithia Motors Inc. in Medford, OR, has long been to buy poor performing stores, many of them Chrysler brands, and put them in working order. But the dealership chain is beginning to eye luxury and premium brands. It has room to grow in those areas.

A Cadillac dealership is an attractive bet again, that is, if it is one of the brand's 300 top performing stores. “You can buy a Cadillac store today that is making the same money as a Toyota store and pay a lot less money for it,” Sandler says.

Chevrolet is another General Motors Corp. brand that might be a wise investment. “GM is further along with its corrective measures,” says Tom Libby, director of consulting and an analyst for J.D. Power and Associates' Power Information Network. “Also, the brand has a wide product portfolio.”

Sandler believes Saturn is the brand to buy right now (*see story on page 30*). “It's true the brand has wasted a lot of good will (from its high customer satisfaction) and the question is, can they get the buzz back,” he says. “It's only one issue, but it is a big issue.”

Still, he argues the brand has tremendous upside. The dealerships are inexpensive, the new products are strong and dealers have the luxury of a large market area. “There is a risk/reward proposition,” Sandler says.

The dealerships are cheap because “No one is buying them,” he says. “And that is because not too many people agree with me about its future.”

Cochran, though, says Saturn is showing signs of life at his dealership. The last week of January, sales “just beamed off the charts,” he says. “Our Saturn business has been exceptionally good. I don't know if that's tied into President's Day or tied into finally getting the right exposure to the Saturn projects.”

H. Carter Myers, a Virginia-area dealer and another former NADA chairman, when asked in January about Saturn's possible resurgence, laughed and said, “We're not seeing it in Virginia.”

He just rolled the dice on a Hyundai franchise, building a new facility for a new point a few months ago. Profitability, though, was “teetering,” he says. He made the decision knowing the risks, though.

“I looked at it and saw there are a lot of good dealers with the brand,” Myers says. “I figured they'll either get rid of it or they'll make it work.”

Libby is bullish on Hyundai.

Although the brand has challenges, Libby believes Hyundai will continue to improve long term. It topped Power's Initial Quality Study rankings for all non-luxury brands last year and its 2.8% market share in 2006 is its highest ever.

Sales per dealership went down 50 units in 2006, however, and its days to turn rate is one of the highest in the industry.

Dealer profitability continues to be a big issue for the brand, but that should improve, Libby says, as Hyundai moves more upscale with its products.

Cochran says Hyundai has done well for his group, but Sandler cautions against getting too excited. “There really is no demand for the brand right now,” he says. “Its performance has been spotty, so a lot of dealers aren't willing to spend money on the brand right now.”

Brands on few people's radar are Volkswagen and Audi. “VW could be a hidden brand with some depth,” Charles Oglesby, Asbury's incoming CEO says. “They need to make the right decisions. The overall market is so competitive one mistake could hurt.”

Libby says Audi is “making real progress” and is “becoming more and more of a credible luxury brand.” The brand still has significant quality issues, though. Volkswagen, meanwhile, has lost some of its momentum and has a high cost structure in Germany, which means higher prices here.

“A lot of people think Audi,” Sandler says. “I want to see them get out from under the glass ceiling of BMW and Mercedes and it's going to be hard for them to do that.”

Dark horses are the Ford brands. “They're at the top of our wish list,” Zeigler says. “Our two Lincoln Mercury stores are very hot and the grosses are as high as they have ever been.”

The group likely will close a deal on another dealership in the next six months and has a couple of other ones in the works.

But one executive with a large dealer group says he has a real urgency to get rid of their Ford and Lincoln Mercury stores. “We can't get rid of them fast enough,” he says.

A major Southern California Ford dealer says he recently rebuffed offers from a neighboring import dealership to buy the land on which his store sits because, he says, he believes in Ford.

The dealer conveyed his decision to stick with Ford telling new CEO Alan Mulally he is going to continue riding that horse.

“I'm betting on you,” he tells Mulally.

Mulally responds, “That's good, because you don't want to bet against me.”

Knowing which brands to invest in will never be an exact science. That is one reason the automotive retail industry is so fascinating. Dealers have to be gamblers.

“You've got to take a lot of risks in our business and when you stop taking risks is generally when you start declining,” Cochran says.

“It's like buying a stock,” he says. “Sometimes what's perceived as the most valuable today — and you pay all the money for it today — if it just misses a hair a year from now, it's not such a good year. It's really the future's market as far as what's going to happen.”

— with Emily Prawdzik Genoff

Hyundai: A Real Gamble

We know a lot of people like Hyundai. Just read some of the uninformed headlines comparing the Korean brand with Toyota. We're not convinced. But it still could be an intriguing buy.

Our advice is to place your bets carefully. Many dealers tell us profitability at the store level continues to be an issue. But the brand is implementing a certified pre-owned program and looking to move more of its dealers into exclusive locations, all of which should help profitability.

Sales per franchise declined by almost 50 vehicles despite a record year for share in 2006 — not a mark of a healthy franchise.

Hyundai still has a ways to go in establishing itself as a strong brand. For example, dealers are frustrated with ordering issues. When the vehicles leave the ports in South Korea, it is anybody's guess when they will show up in the U.S.

Management continues to be a big question. Hyundai's U.S. Operating Officer Steve Wilhite unquestionably is a dealer advocate and understands a profitable dealer body makes for a stronger OEM. But some dealers tell *Ward's* they are skeptical of just how much leeway the Koreans will give him.

Our take: Be careful when rolling those dice.
— *Cliff Banks*

Audi: The Sleeper

Audi is on a lot of people's radar screens. Product is a big reason. Is there a better vehicle in its segment than the Audi S8?

Public dealer groups are looking at Audi as a possible acquisition opportunity. Audi might be a nice and cheaper alternative to BMW, Mercedes or Lexus, but there are only 266 dealerships available, and that number might come down. *(See story on pg. 31.)*

And there is that annoying currency-exchange problem that hampers real growth in the U.S. Vehicles have to be priced higher to compensate. But BMW has the same challenge. Still, Audi and Volkswagen managed to increase their sales per dealership in 2006, a sign of a healthy brand.

But Audi dealers have issues with senior management in Germany and claim poor marketing support and a lack of understanding of the U.S. market are the real culprits hindering sales.

Our take: Stay away from the table until the Germans start playing nicer.
— *Cliff Banks*

Nissan: Depends on the Year

After a lot of hype and substance with Nissan's turnaround, 2006 proved to be a rough year. Market share dropped 4.5% while average store sales decreased approximately 30 units.

But 2007 will be better. A slew of new products hitting the showroom this year along with stronger than average dealer profits mean this brand could be a winner.

Dealers appear to be happy with management so the asking price might be high. But there are reasons to be cautious.

“Its performance has been inconsistent,” says Tom Libby, an analyst with J.D. Power and Associates. “We don't have a real clear picture of the long term future. It's a potential sleeper, though.”

Sheldon Sandler, founder of investment firm Bel Air Partners says Nissan is fourth on his list of attractive sleeper brands.

“The brand took a breather for a year,” he says. “But that new product is better than ever.”

Our take: Put some money on this horse.
— *Cliff Banks*

Saturn — The Sure Bet?

Saturn, the new must — have brand? It may not be as farfetched as you think. In fact, we're saying you should take a hard look at the brand — it might be a real winner.

Yeah, we know it's always easier to gamble with someone else's money, but there is a story here.

It's all about return on investment. Brokers tell us you could pick up a Saturn store on the cheap. And that means you won't have to wait three to five years to start making money on it, as you would with one of the premium brands.

There might be stores available.

“A lot of dealers have run their course with Saturn,” says Sheldon Sandler, founder of Bel Air Partners, an investment firm that handles acquisitions for many of the larger dealer groups. “It's a unique situation because the brand is an old/new company.”

It's one of 17 brands to increase its sales per franchise — 488 in 2005 to 511 in 2006 (See chart on p. 28). Saturn also is one of two General Motors Corp. brands to increase share year over year. And its days to turn rate is under 50 days, not bad for a non-luxury brand.

A heralded revamped product line beginning with the new Aura and Outlook combined with Saturn's longtime reputation for customer satisfaction could be a real winner the next few years.

With several vehicles sharing a platform with the Belgian-based Opel, GM is turning Saturn into more of a European-styled brand in an effort to attract buyers on the coasts.

GM will have to maintain the momentum with savvy marketing to make sure the Saturn message does not get lost on its customers. That marketing also will play a big role in whether Saturn and Chevrolet maintain enough of a distinction so as not to cannibalize each other.

Whether GM can pull that off is a big enough question to leave Tom Libby, an analyst with JD Power and Associates, skeptical. “They're moving away from their core model,” he says. “The underlying brand identity is softening. My personal opinion is that over the long term, Saturn and Chevy will overlap.”

Our opinion — you probably can't go wrong buying Saturn today.
— *Cliff Banks*

Dealer Sales Per Franchise

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Company	Brand	2006 Sales	# of Franchises	Sales/Franchise '06	Sales/Franchise '05
BMW	BMW	274,432	345	795	785
BMW	Mini	39,171	80	490	510
Chrysler Corp.	Chrysler	604,874	2,870	211	226
Chrysler Corp.	Dodge	1,077,579	2,845	379	411
Chrysler Corp.	Jeep	460,052	2,730	169	171
Ford Motor Co.	Ford	2,364,016	3,713	637	685
Ford Motor Co.	Jaguar	20,683	181	114	172
Ford Motor Co.	Land Rover	47,774	175	273	272
Ford Motor Co.	Lincoln	120,476	1,349	89	91
Ford Motor Co.	Mercury	180,848	1,945	93	100
Ford Motor Co.	Volvo	115,807	356	325	347
General Motors	Buick	240,657	2,748	88	102
General Motors	Cadillac	227,014	1,469	155	159
General Motors	Chevrolet	2,397,408	4,058	591	645
General Motors	GMC	457,902	2,498	183	241
General Motors	Hummer	71,524	173	413	332
General Motors	Pontiac	410,229	2,758	149	157
General Motors	Saab	36,349	243	150	155
General Motors	Saturn	226,375	443	511	898
Honda	Acura	201,223	276	729	797
Honda	Honda	1,308,135	1,019	1,284	1,234
Hyundai	Hyundai	455,520	754	604	655
Isuzu	Isuzu	8,614	227	38	41
Kia	Kia	294,302	644	457	432
Mazda	Mazda	268,786	683	394	364
Mercedes Benz	Mercedes Benz	247,793	342	725	665
Mitsubish	Mitsubishi	118,558	517	229	228
Nissan	Infiniti	121,146	176	688	762
Nissan	Nissan	898,103	1,068	841	878
Porsche	Porsche	34,227	201	170	160
Subaru	Subaru	200,703	600	335	333
Suzuki	Suzuki	100,990	540	187	153
Toyota	Lexus	322,434	221	1,459	1,409
Toyota	Scion	173,034	919	188	173
Toyota	Toyota	2,047,056	1,224	1,672	1,482
Volkswagen	Audi	90,116	266	339	312
Volkswagen	Volkswagen	235,140	608	387	369
Total	>	**16,499,050**	**41,264**	**400**	**431**

Source: WardsAutoInfoBank