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Trends in the New Vehicle Dealer Sector

The car dealer is a long-standing fixture on the North American landscape - one of those Norman Rockwell neighbourhood pillars that, while not as fundamental as the schoolhouse or fire station, is significant in its own right. It is the fulfiller of dreams and the granter of mobility and freedom. It is also an important employer, providing about 150,000 jobs in communities small and large.

It is disheartening to learn that this staple has fallen on hard times.

Trends in the new vehicle dealer industry tend to mirror those in the wider auto sector. As with any entity in an industrial supply chain, dealers are inextricably linked to the mood of the economy and the fortunes of their respective franchise brands. The automotive sector commands a great deal of total revenue

- \$156.1 billion spread across four primary areas in 2007:

- New vehicle sales -- \$52.5 billion
- Used vehicle sales -- \$28.5 billion
- Automotive finance -- \$57.8 billion
- Automotive aftermarket -- \$17.3 billion

Taken separately or together, the Canadian auto industry and its various sub-sectors represent a sizeable chunk of our economy, so it's no wonder that attention is paid from government and media perches.

Approximately one out of every seven jobs in Canada is tied directly or indirectly to the automotive industry. This is as much a human story as it is one of economics.

While they represent what is arguably the most important point of contact between the

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Dealer Participation in Automotive Revenue - Canada (\$ Billions)

	Total Revenue New Vehicle Sales	Total Revenue Used Vehicle Sales	Total Revenue Parts and Service Sales	Total Revenue Automotive Finance Sales	Total Automotive Revenue In Canada	Total Revenue Through A New Vehicle Dealer	New Vehicle Dealer Share
2000	\$45.8	\$20.5	\$13.9	\$42.2	\$122.4	\$59.0	48.2%
2001	\$46.1	\$21.2	\$14.4	\$44.8	\$126.5	\$59.3	46.9%
2002	\$51.3	\$22.8	\$15.1	\$49.3	\$138.5	\$65.5	47.3%
2003	\$49.5	\$24.0	\$15.5	\$52.2	\$141.1	\$64.4	45.6%
2004	\$48.4	\$25.5	\$16.0	\$49.9	\$139.8	\$64.7	46.3%
2005	\$50.8	\$25.6	\$16.1	\$53.1	\$145.7	\$68.3	46.9%
2006	\$52.7	\$25.6	\$16.7	\$54.2	\$149.2	\$70.0	46.9%
2007	\$52.5	\$28.5	\$17.3	\$57.8	\$156.1	\$69.8	44.7%

Source: PricewaterhouseCoopers LLP/DesRosiers Automotive Consultants Inc. Profitability Survey

Observations - "Trends in the New Vehicle Dealer Sector"

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auto industry and its consumer body, new car dealers are not the only pipe through which revenue flows. There are many other players competing for the business of vehicle buyers and maintainers in Canada. We estimate that \$69.8 billion of the aforementioned \$156.1 billion flowed through new car dealers in 2007 (roughly 44.7 percent). This figure has fallen over the past decade as competition from independent used vehicle dealers and the traditional aftermarket continues to grow. As recently as 2000, new vehicle dealerships accounted for 48.2 percent of total automotive-related revenue in Canada.

Although dealers retain a large share of total auto industry revenue, per-dealer profitability has taken a surprising hit in recent years. The total gross profit margin has remained around 13 percent of total sales, but net profitability (measured as return on sales of new vehicles, used vehicles, parts, service, finance & insurance, and collision where applicable) has dropped off considerably to 1.65 percent - down from 2.4 percent in 2004. In other words, net dealership profits dropped to only \$1.1 billion between 2004 and 2007 - a decline of approximately one third!

Extrapolating across Canada's 3,455 new vehicle dealers yields an average net profit of around \$331,100 per store - down from a peak of \$442,500 per store in 2004. We believe that most dealers have an average of \$5 million in assets on the ground (with many holding three to five times that number at any given time, but with an equally large number holding far less), so net profits per dealer relative to their investments are surprisingly low. With such thin margins, it's easy to understand why Canada loses 30 to 50 stores to bankruptcy every year. The margin for error in operating a dealership is razor-thin.

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Automotive Revenue - Canada

(\$ Billions)

	Total Automotive Revenue in Canada	Total Revenue Through a New Dealer	Total Gross Profit at New Vehicle Dealers	Total Gross Profit Margin	Return on Sales	Total Fixed and Variable Costs	Total Net Profit
2000	\$122.4	\$59.0	\$7.8	13.30%	2.10%	\$6.6	\$1.2
2001	\$126.5	\$59.3	\$8.1	13.60%	2.10%	\$6.7	\$1.4
2002	\$138.5	\$65.5	\$8.7	13.30%	2.15%	\$7.3	\$1.4
2003	\$141.1	\$64.4	\$8.8	13.70%	2.20%	\$7.4	\$1.4
2004	\$139.8	\$64.7	\$9.0	13.90%	2.40%	\$7.4	\$1.6
2005	\$145.7	\$68.3	\$9.3	13.50%	2.20%	\$7.8	\$1.5
2006	\$149.2	\$70.0	\$9.2	13.10%	1.90%	\$7.9	\$1.3
2007	\$156.1	\$69.8	\$9.0	12.90%	1.65%	\$7.9	\$1.2

Per Dealer Average

	Number of Dealers	Revenue Per Dealer (\$ Millions)	Gross Profit Per Dealer (\$ Millions)	Gross Profit Margin	Return on Sales	Fixed Cost Per Dealer (\$ Millions)	Net Profit per Dealer (\$ Thousands)
2000	3,569	\$16.5	\$2.2	13.30%	2.10%	\$1.9	\$347.3
2001	3,521	\$16.8	\$2.3	13.60%	2.10%	\$1.9	\$404.4
2002	3,583	\$18.3	\$2.4	13.30%	2.15%	\$2.0	\$393.2
2003	3,535	\$18.2	\$2.5	13.70%	2.20%	\$2.1	\$400.8
2004	3,507	\$18.4	\$2.6	13.90%	2.40%	\$2.1	\$442.5
2005	3,489	\$19.6	\$2.7	13.50%	2.20%	\$2.2	\$431.0
2006	3,476	\$20.1	\$2.6	13.10%	1.90%	\$2.3	\$382.7
2007	3,455	\$20.2	\$2.6	12.90%	1.65%	\$2.3	\$331.1

Source: PricewaterhouseCoopers LLP/DesRosiers Automotive Consultants Inc. Profitability Survey and Canadian Automobile Dealers Association (CADA)

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There are nearly 2,000 dealers selling fewer than 500 new and used vehicles per year. The annual profitability of these dealers is significantly lower than the overall average, but the cost of doing business at all levels continues to rise. The OEMs have put tremendous pressure on dealers to re-image their stores, requiring regular capital injections. With no improvements in gross profitability, net profits have suffered at the altar of image programs and greater sophistication. Furthermore, image programs require not only bricks-and-mortar upgrades but also investment in new equipment, technology and training.

The ever-increasing sophistication of new vehicles requires concurrent improvements in HR sophistication and education programs. A service professional can easily earn more than \$100k per year, and that same technician requires

frequent and significant re-training to stay current with new technologies. All of these requirements add to the already-weighty costs of dealer operation. Not only have the fixed costs (land, facilities, and equipment) risen, but variable costs (human resources) have also increased to the point where they have begun to have a major effect on the return on sales.

When it actually comes down to the business of selling vehicles, most people would be taken aback at the average per-vehicle net dealer profit in Canada: only \$448. That's it folks! This includes profits from all other departments within the dealer, including parts and service. A common misconception among consumer is that dealers have negotiating wiggle room on the order of several thousand dollars. This is simply not the case. Dealers make a fairly significant gross profit, but when the cost of doing business is taken into account, most of these profits are blown out the door.

Worse yet, per-vehicle profits have been falling for the past decade. From a high of \$635 in 2004, average net profits have fallen \$187 in the past three years. Indeed the \$448 per vehicle number includes profits from selling used vehicles, parts and service etc. If net profit per new vehicle could be isolated one would find many new vehicles are actually sold as loss leaders in order to generate profits in other business units at a dealership.

We divide dealers into five size categories:

- "A" dealers sell more than 2,000 new and used units per year
- "B" dealers sell 1,001 to 2,000 new and used units per year
- "C" dealers sell 501 to 1,000 new and used units per year
- "D" dealers sell 251 to 500 new and used units per year
- "E" dealers sell up to 250 new and used units per year

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Dealership Profitability Per Vehicle Sold

	New Vehicle Sales	Used Vehicle Sales By New Car Dealers	Vehicles Sold New Car Dealers	Total Net Profit (\$ Millions)	Total Net Profit Per Dealer (\$ Thousands)	Net Profit for New Car Dealers Per Vehicle Sold (Dollars)
2000	1,549,441	918,619	2,468,060	\$1,239.6	\$347.3	\$502
2001	1,570,629	867,681	2,438,310	\$1,423.9	\$404.4	\$584
2002	1,703,246	909,148	2,612,394	\$1,408.8	\$393.2	\$539
2003	1,593,506	898,649	2,492,155	\$1,416.7	\$400.8	\$568
2004	1,534,415	908,353	2,442,768	\$1,551.8	\$442.5	\$635
2005	1,583,291	904,669	2,487,960	\$1,503.7	\$431.0	\$604
2006	1,614,701	905,836	2,520,537	\$1,330.4	\$382.7	\$528
2007	1,653,388	915,280	2,568,668	\$1,150.9	\$331.1	\$448

Source: PricewaterhouseCoopers LLP/DesRosiers Automotive Consultants Inc. Profitability Survey, AIAMC, CADA and CVMA

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Most of the growth in today's vehicle dealer industry is in the upper two size segments, "A" and "B". We believe this trend is likely to continue. As margins are squeezed, it is the smaller dealers who will struggle to satisfy the dueling demands of market pressures, image programs, and technological change. Sales per store will rise as the market remains healthy, but it is becoming harder and harder for smaller stores in larger communities to survive. The writing is on the wall for single-store car dealers in metro markets. They may be able to survive in smaller markets but most will struggle in the large urban markets.

As a result, we have seen a significant rise in multi-ownership across Canada. Indeed, the rise of multi dealer ownership has been forceful and dramatic. The same factors that are writing the death knell of small dealers have propelled the growth of dealer groups. Need for capital, consistent imaging and branding, and constant technology upgrades have made the operation of a car dealer the

New Vehicle Dealer Structure

Sales Per Store

	2005	2006	2007
Small (under 250 units)	234	239	240
Medium to Small (under 251-500 units)	486	488	485
Medium to Large (under 501-1000 units)	842	865	876
Large (under 1000-2000 units)	1,440	1,460	1,495
Mega Stores (2000+ units)	2,610	2,650	2,760
Total	711	726	740

Note: Size is for new and used units together

Number of Dealers

	2005	2006	2007
Small (under 250 units)	825	824	820
Medium to Small (under 251-500 units)	949	950	940
Medium to Large (under 501-1000 units)	1,250	1,230	1,210
Large (under 1000-2000 units)	375	380	390
Mega Stores (2000+ units)	90	92	95
Total	3,489	3,476	3,455

Note: Size is for new and used units together

Source: PricewaterhouseCoopers LLP/DesRosiers Automotive Consultants Inc. Profitability Survey

province of big business. There are now 83 dealer groups in Canada owning four or more stores apiece. These groups control over 900 individual dealer points, equaling roughly 38 percent of the market. Another 160 owners control two or three stores, and this cohort of smaller dealer groups accounts for 360 stores or

approximately 16 percent of the market.

Consider this trend: just 240 owners control well over half the vehicle sales in Canada. Single point stores are having trouble staying afloat as it becomes more difficult for small fish to swim in a sea populated by an overwhelming number of sharks and whales. In 2007, the ranks of owner/operator dealers have thinned to around 2,100 dealers - a decline of almost 1,400 individuals when measured over the past decade. There will always be a role for small car dealers, especially in the "C" to "E" sized stores, but the ability of these owner/operators to survive in the midst of larger stores is questionable.

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Multi Store Ownership - 2007

	Number of Owners	Number of Stores	Share of Stores	Share of Vehicle Market
3+ Stores	83	925	27%	38%
2 - 3 Stores	160	360	10%	16%
Single Point	2,170	2,170	63%	46%
Total	2,413	3,455	100%	100%

Source: PricewaterhouseCoopers LLP/DesRosiers Automotive Consultants Inc. Profitability Survey and Canadian Automobile Dealers Association (CADA)