Cox Automotive

TURN TO EARN

Speeding the Wholesale-to-Retail Process Is Critical to Growing Market Share & Operational Profitability

ABSTRACT

Since 2009, the gap between list price and transaction price has steadily declined. To overcome this profit margin compression, dealers must increase overall operational profitability by:

- Reducing overhead,
- Freeing dealership resources to focus on profit centers, and
- Selling more vehicles at a faster rate rather than maximizing gross per unit.

Because infusing speed and efficiency into the wholesale-to-retail process is a particularly effective and increasingly necessary way that progressive dealerships can meet these goals, best practices have been identified that will help dealerships increase their speed to market.

Since 2009, used retail gross margin has steadily declined, reaching its peak at 11.5% in 2009 and dropping steadily to approximately 9% in 2015 (see Diagram A).[1] This decline has been exacerbated by an unexpected accompanying increase in wholesale vehicle prices, which rose in both 2014 and 2015. While analysts expected higher vehicle volume to push wholesale prices down, they actually increased as a result of record retail profit opportunities available to dealers in 2015.[2] These near-record wholesale prices were the result of several factors, including strong new vehicle pricing, higher employment levels/ job stability and increased dealership operating efficiencies.[2]

To overcome this profit margin compression, dealers must increase overall operational profitability by:

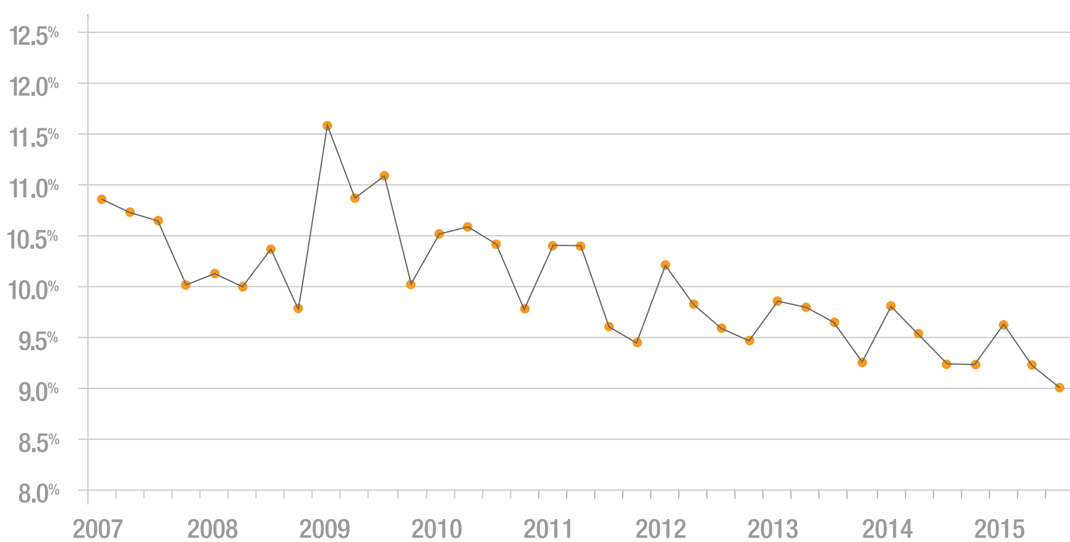
- Reducing overhead,
- Freeing dealership resources to focus on profit centers such as fixed ops (which accounts for 46% of gross on average[3]) rather than ancillary services such as reconditioning, and
- Selling more vehicles at a faster rate rather than maximizing gross per unit.

Infusing speed and efficiency into the wholesale-to-retail process — from inventory identification, acquisition and floor-planning to inspection, transportation and merchandising — is a particularly effective and increasingly necessary way that progressive dealerships can meet these goals.

Diagram A[1]

USED VEHICLE RETAIL GROSS MARGIN

(PUBLICLY-TRADED DEALERSHIP GROUPS)*



*KMX shifted forward one month to correspond with calendar quarter sales-weighted average for KMX, AN, PAG, SAH, GPI, ABG, and LAD

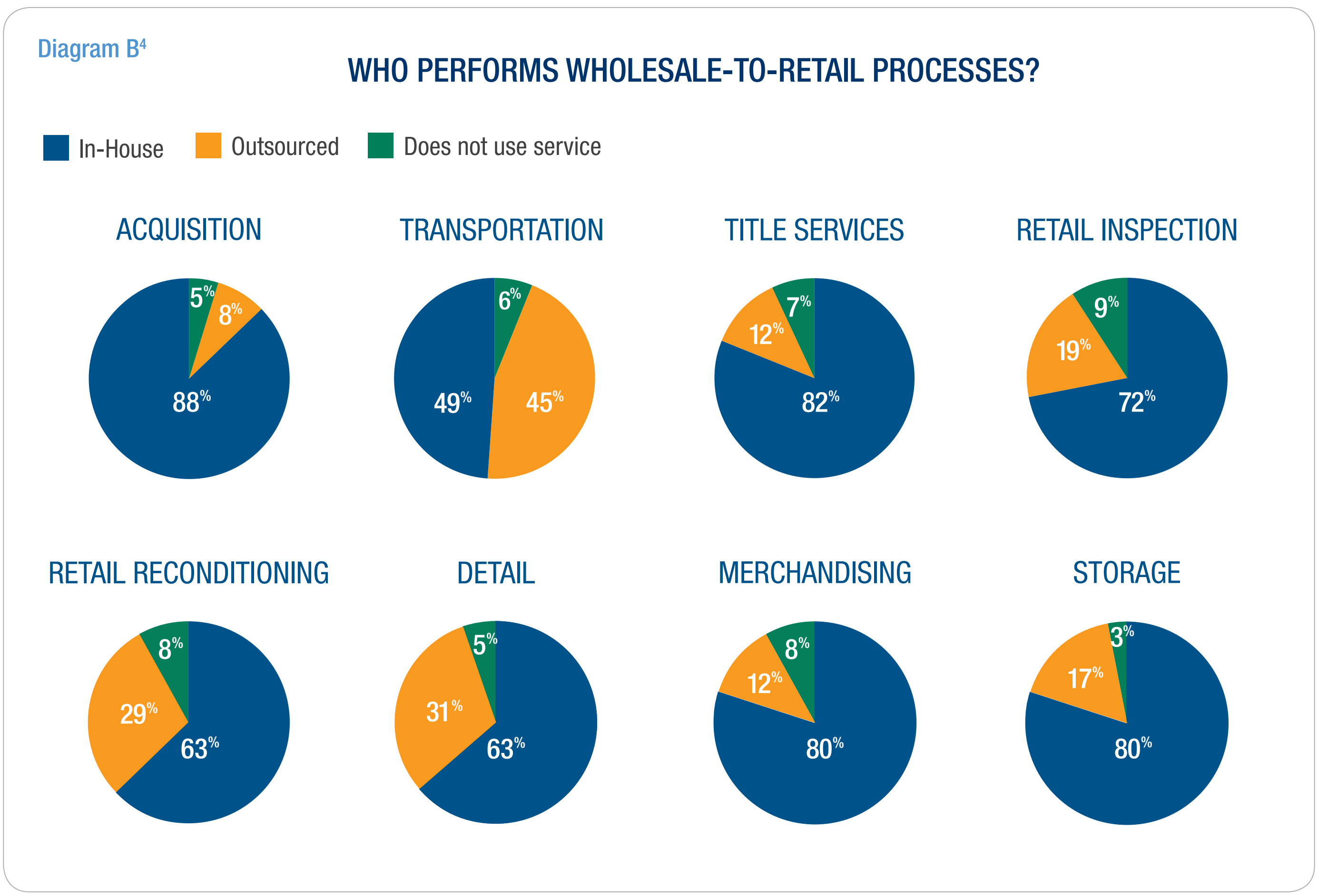
Since 2009, used retail gross margin at publicly traded dealership groups has steadily declined.

Time Is Money

Most dealers handle wholesale-to-retail-related activities in-house. For example, 88% of dealers handle wholesale inventory acquisition on their own while only 5% use outsourced solutions to maximize their operations.[4] Likewise, when it comes to outsourcing specialized services designed to maximize efficiency so that dealership resources can be reallocated to activities that are more directly profit-related (e.g., maintenance and repair services), only 19% do so for retail inspections, 29% for reconditioning, 31% for detailing, 8% for merchandising and only 3% for storage (see Diagram B).[4]

On average, this largely in-house-managed process takes upwards of 10 days to get used inventory frontline-ready. Most dealers perform detailing, imaging, mechanical work, merchandising, wheel/tire work and paint/body work. Wheel/tire work and paint/body work alone can add about one extra day before the vehicle is frontline-ready.[5]

Progressive dealers are already taking action in these areas to protect their margins and market share by speeding the wholesale-to-retail process: The top 20% of dealers are accomplishing all of these tasks in less than four days.[6] Similarly, the average number of days it takes online listings to be merchandised with photos and descriptions from the time a vehicle appears in a dealer's inventory is 12.5 days, yet the top-performing 20% of dealers do it in 4 or less .[6] These dealerships are best positioned to sell the most vehicles in today's marketplace where the car-shopping process can be swift. Consumers now have unprecedented access to online inventory information and are inclined to limit their lot visits and test drives: 38% of car shoppers only visit only one dealership[7] and 52% only test drive one vehicle.[7] The car buying process only takes an average of 14 hours and 44 minutes, 59% of which is spent researching and shopping online.[7] 71% of car buyers end up purchasing the vehicle that they had in mind when they initially visited the dealership, indicating that most car buyers are making purchase decisions online.[7] Therefore, it is vital that dealerships get the right inventory online, and on the lot, as soon as possible.



The majority of dealers handle most wholesale-to-retail processes in-house.

The Advantages of Volume

Dealers that can determine what car shoppers want and then bring the most of those vehicles quickly to market at the most competitive prices are the ones who will likely be most successful. Focusing on high sales volume as opposed to high profit margins is a preferred model for gaining market share in a wide variety of industries. It is no wonder, then, that companies with advanced logistics capabilities like Walmart and Amazon are leaders in market share. Likewise, to gain automotive market share, dealers need to hone their logistical capability to sell cars as quickly as the market demands instead of holding out for more gross profit per vehicle. Speeding the wholesale-to-retail process is critical to achieving a high-volume sales model.

In addition to gaining market share and increasing turn (and therefore overall profits), adopting a high-volume strategy can also allow dealers to reduce overhead expenses. For example, focusing on margin instead of turn often results in having too many aged vehicles in inventory, which increases holding costs that average $32 to $40 per day per vehicle.[5] And ironically, holding out for increased gross can have the opposite net effect at the end of the day: Vehicles that are on the lot for over 30 days tend to sell at a much lower margin than those that have been on the lot for 30 days or less (See Diagram C).[8] Currently about 20% of cars sit on the lot for more than 50 days.[5]

Speeding the merchandising phase of the wholesale-to-resale process can shorten the amount of time that inventory remains on the lot, thereby increasing overall dealership profitability (see Diagram D).[9] For example, when Dealer A takes an average of 11 days to publish photos and a description of a vehicle on their dealer website and an average of 9 days to get that vehicle merchandised on Autotrader.com, that vehicle spends an average of 35 days on the lot. However, when Dealer B takes an average of only 1 day to publish photos and a description of a vehicle on their dealer website and an average of 1 day to get that vehicle merchandised on Autotrader.com (see the following “Merchandising” section for more about how to achieve this), that vehicle will spend an average of only 22 days on Dealer B’s lot.[9] If the average daily holding cost is $40 per vehicle,[5] that’s a savings of $520 that can be added into the profit on this unit alone. And when you factor in the rate at which used vehicle margins decline over time — an average margin of $1313 for vehicles sold in under 30 days compared to only $75 for vehicles sold in over 30 days (see Diagram C)[8] — it is easy to see how these savings can quickly multiply as inventory turn is increased thanks to faster and more efficient merchandising.

Diagram C[8]

USED VEHICLE MARGINS **DECLINE** OVER TIME

MO/YR	UNDER 30 DAYS		
6/1	UNITS	FRONT GROSS	AVERAGE
Cumulative Total >	35	$45,965	$1,313
STOCK #			
E057072A	1	$750	750
EB077145	1	$2,037	2037
E049506A	1	$2,298	2298
E029073A	1	($329)	-329
B084441A	1	$790	790
H531403A	1	$3,288	3288

MO/YR	OVER 30 DAYS		
	UNITS	FRONT GROSS	AVERAGE
Cumulative Total >	19	$1,419	$75
STOCK #			
B028626A	1	$908	908
C224303	1	($190)	-109
7715661	1	($1,519)	-1519
A224195	1	($91)	-91
Y210460	1	$355	355
R688178	1	($1,687)	-1687

Speeding the transport phase of the wholesale-to-resale process can also boost overall operational profitability by further reducing vehicle holding costs. This tactic illustrates how truly improving overall efficiency requires comparing costs and savings across all facets of wholesale-to-retail operations. For example, in 2015 it took dealerships an average of 3.42 days to deliver a vehicle 196 miles at a cost of .95 per mile (based on 1.1 million vehicles transported across the remarketing marketplace inbound and outbound from auction).[10] It may seem logical to try to reduce these transportation costs by opting to have vehicles delivered in 6 days, as opposed to 3, for a cost reduction of .85 per mile. In this scenario, the dealer could either have 500 vehicles delivered (annually) 196 miles in 3 days for a cost of $186 per vehicle, or $93,000 annually, or have 500 vehicles delivered 196 miles in 6 days for a cost of $166 per vehicle, or $83,000 annually. That's an annual savings of $10,000. However, $40/day in vehicle holding costs for 3 days = $120, or $60,000 annually compared to $40/day in vehicle holding costs x 6 days = $240, or $120,000 annually. In the big picture, increasing transportation time to save $10,000 annually can actually result in $60,000 in additional holding costs (see Diagram E).[10] This is but one example of why streamlining wholesale-to-retail operations must be viewed in terms of holistic solutions.

Diagram D[9]

SPEED TO MARKET CORRELATES TO INVENTORY TURN = **PROFITABILITY**

	AVERAGE # DAYS TO WEBSITE WITH PHOTOS	AVERAGE # DAYS TO AUTOTRADER WITH PHOTOS	AVERAGE # DAYS IN INVENTORY
DEALER A	11	9	35
DEALER B	1	1	22

Speeding the merchandising phase of the wholesale-to-resale process can shorten the amount of time that inventory remains on the lot.

Diagram E[10]

TRANSPORTATION COSTS VS. HOLDING COSTS

500 VEHICLES DELIVERED IN **3** DAYS

.95 X 196 MILES = $186

$93,000 annually

$40/DAY HOLDING COST X 3 DAYS = $120

$60,000 annually

VS.

500 VEHICLES DELIVERED IN **6** DAYS

.85 X 196 MILES = $166

$83,000 annually

$40/DAY HOLDING COST X 6 DAYS = $240

$120,000 annually

Which would you rather have…

$10,000 transportation savings or **$60,000** additional holding costs?

What Dealers Can Do

While 72% of dealers manage all wholesale activities internally, only 52% of dealers are satisfied with their current wholesale process.[11] Managing disparate activities — from transport and inspection to reconditioning and merchandising — can involve a significant commitment of internal resources and/or a sizable investment in a variety of outsourced solutions. Reluctance to change such a complex established set of processes, even though they may be less than satisfactory, is therefore understandable. However, following are ways that progressive dealers may be able to increase their market share and operational profitability over the long haul by infusing speed and efficiency into the wholesale and retail vehicle life cycle (see Diagram F).

Diagram F

INFUSE SPEED & EFFICIENCY INTO THE WHOLESALE & RETAIL VEHICLE LIFE CYCLE

Inventory Identification, Acquisition & Inspection

Know What & Where to Buy

The ever-growing variety of available auction cars makes it difficult to know how a specific vehicle's color, equipment, mileage, ownership history and trim level will play against competing cars. Technology and tools can provide dealers with specific stocking recommendations based on demand in their market, their sales volume and profit goals. For example, vAuto's Stockwave can aggregate listings from multiple auction houses across the country and display profit potential and maximum recommended bids for each vehicle.

Buy at the Right Price

Technology and tools can help dealers determine the maximum they can afford to pay on every vehicle by calculating each unit's profit potential while factoring in reconditioning, transportation and other costs. It may take discipline to stick to predetermined pricing parameters, particularly when bidding on vehicles that seem as though they are ideal for the dealership's demographic. However, sticking to a precise bidding strategy can be critical to maintaining overall profitability in a marketplace where margins are increasingly compressed.

Expand Sourcing Efforts

Looking beyond the local auction can help dealers build auction shopping lists that include alternative choices if they can't get the cars they want the most. The challenge then becomes how to determine which auctions tend to feature cars that best fit a dealership's strategy. The most proficient dealers and buyers rely on technology to tell them where their most desired vehicles can be sourced.

Buy Online

Simulcast auctions and online wholesale marketplaces, like those provided by Manheim, can expand a dealer's radius to provide fast and convenient access to a wider variety of vehicles that align with a dealership's strategy. When buying online, vehicles should be inspected before they leave the auction. Condition reports and purchase protection programs can help prevent arbitration. According to Manheim 2015 Sales Data, condition reports alone result in an average 37% decrease in arbitration.

Floor Planning

Once vehicles have been identified and sourced, the next step is to fund them. Consider partnering with a vendor that can offer the capital and expertise needed to maximize your wholesale strategy. A good floor-plan partner can make inventory available without expanding any dealer capital, so money that otherwise would be tied up in inventory can be invested elsewhere (e.g., facility improvements, marketing/advertising, etc.). This also means that the right floor-plan provider can enable the dealer to retail older, higher mileage or off-brand vehicles that normally would go to wholesale because of limited cash flow. Without cash flow restrictions, these types of vehicles can more easily be retailed within 30 days if priced and merchandised appropriately, thereby reducing holding costs and increasing margins. And selling older/higher mileage inventory rather than wholesaling it opens opportunities to grow F&I revenue through sub-prime finance opportunities that are attractive for payment buyers. Those financing opportunities can also lead to sales of products like warranties, gap insurance and wheel & tire coverage.

Dealers should look for a floor-planning provider that is not just a lender, but is a consultative partner that understands the dealership's business model and can help identify the vehicles that are most effective for the dealership's market. A floor-planning partner should also:

- Provide integration with technology to maximize convenience and efficiency (e.g., mobile tools);
- Understand the dealership's profit centers;
- Drive more vehicles into the service department; and
- Help increase F&I sales.

The optimal floor plan provider should also function seamlessly in tandem with the auction provider to offer fast and convenient financing for the entire acquisition process, from purchasing and inspections to title services and transportation. A floor planning provider that offers integration with auction platforms can provide the speed and agility that is critical for competitive dealerships to acquire sought-after vehicles and get them to market quickly.

Transportation Logistics

Consider centralizing with a trusted (and insured) transportation provider that specializes in smaller loads, can optimize loads with carriers for the best price, and can provide guaranteed prices, transportation routes and schedules. Centralizing transportation can result in an approximate 50% reduction in the amount of time it takes to get vehicles from the auction to the dealership (see Diagram G).[10] Manheim customers can use Ready Logistics and CentralDispatch solutions to find out which services can transport cars to the dealership so that they are ready to sell within a few days. Look for a transportation partner that:

- Understands your business and functions as a collaborative partner.
- Leverages technology integration with transportation partners to streamline the process.
- Minimizes risk by being compliant with MC (Motor Carrier) authority safety ratings.
- Provides real-time route information.

Diagram G[10]

CENTRALIZED TRANSPORTATION PROCESS RESULTS

AVERAGE DAYS TO DELIVER

	Pre-Centralized Transportation Provider	Post Pre-Centralized Transportation Provider	Improvement
Auction 1, New Mexico	9.43	5.00	4.43
Auction 2, Harrisonburg	12.25	6.26	5.99
Auction 3, Fredericksburg	8.61	5.58	3.03
Auction 4, Albany	11.85	5.65	6.20
Auction 5, California	10	4.68	5.32

50%
Improvement
(approximate)

Centralizing transportation can result in an approximate 50% reduction in the amount of time it takes to get vehicles from the auction to the dealership.

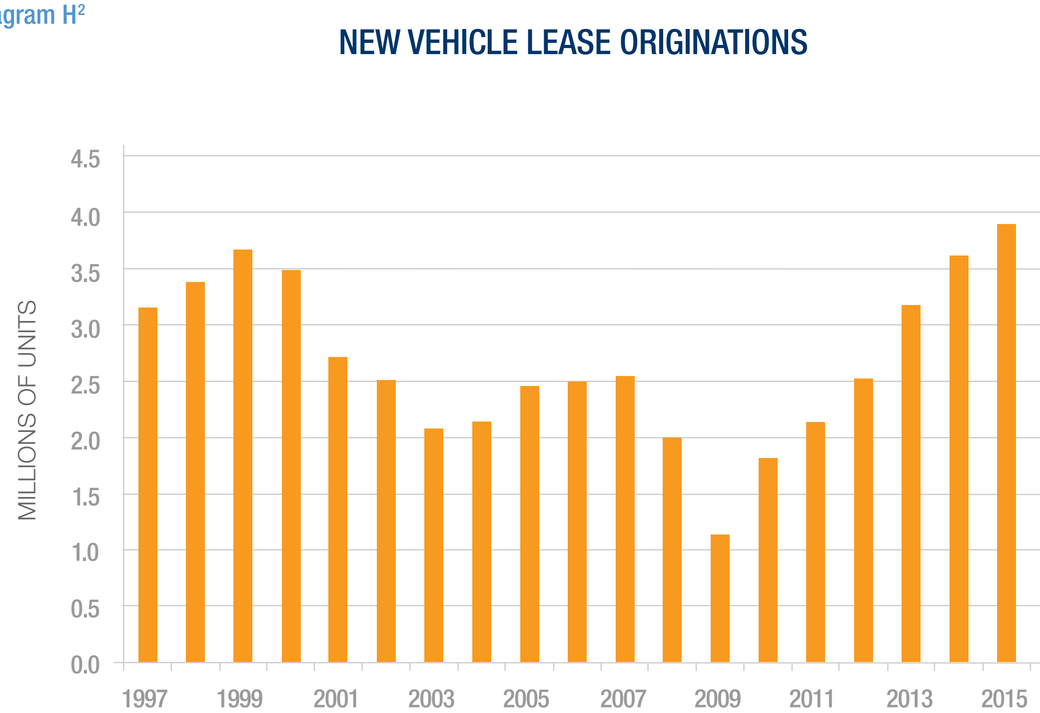
Reconditioning & Detailing

Buying vehicles that have been reconditioned and detailed at the auction means getting them on the front-line faster and increasing inventory turn. It can also mean cost savings when personnel and resources that would normally be relegated to wholesale vehicle refurbishment can be allocated to other activities — such as maintenance and repair — that drive profit for the dealership. Many Manheim auctions, for example, feature a full range of services — from detailing to light mechanical repairs — in a one-stop shop designed to eliminate logistic and scheduling hassles so that dealers can concentrate on selling retail-ready vehicles and completing profit-generating work orders. Since fixed operations drives nearly half of dealership gross,[3] allocating more highly skilled (and compensated) personnel to this vital profit center rather than to reconditioning can be an effective tactic for combatting margin compression while generating revenue that can be invested in facets of dealership operations which may be more economically outsourced — reconditioning in particular.

Merchandising

Getting vehicles online before they leave the auction can significantly improve the chances of turning inventory quickly. Where possible, even if the auction vehicle needs reconditioning, photos can be taken with a mobile device or acquired from a wholesale listing or condition report and posted online while the vehicle is in transition so that consumers are immediately informed where they can buy in-demand inventory. Photos of the actual vehicle are more compelling than stock photos (or a "Coming Soon" placeholder) and can attract buyers who want to get to the vehicle first. In fact, multiple custom photos versus a stock photo increases click-through to the VDP by 364%.[12] Once a car arrives at the dealership, temporary photos can be replaced with high-quality ones. Manheim imaging services can provide high-quality, retail-ready photos at the auction. If it's not possible to get vehicle photos online before leaving the auction, detail the vehicle before reconditioning in order to get photos online within 24 hours of arrival at the dealership.

Diagram H[2]



New vehicle leases have grown steadily since 2009.

Why Change Now?

Declining profit margins, increasing wholesale vehicle supplies, growing opportunities in fixed ops and macroeconomic trends all indicate that now is the time for progressive dealers to gain a competitive advantage by speeding and streamlining wholesale-to-retail operations. Opportunities abound for dealers who take into account:

Increasing Wholesale Supplies

Nearly 4 million new vehicle lease originations in 2015 (see Diagram H)[2] will add to the forecasted continuing increase in used vehicle volume as total wholesale off-lease supply is projected to be over 3 million in 2016, growing to approximately 4 million by 2018 (see Diagram I).[2] While the wholesale vehicle supply/demand ratio may favor lower margins, it may also benefit dealers committed to a high-volume sales model.

Growing Used Vehicle Sales Opportunities

Consumer demand for used vehicles is likely to remain strong. Used vehicle sales at franchised dealerships have increased for 6 consecutive years[2] and in 2015 used vehicle sales by new-vehicle dealerships approached nearly 15 million.[13] Even consumers who are predisposed to shop for new vehicles are likely remain open to considering used vehicles during their shopping process. In fact, in 2016, 36% of new car buyers considered both new and used vehicles[7] and 55% of used car buyers considered both new and used vehicles.[7] When they first begin to shop, 6 out of 10 car buyers are open to considering multiple vehicle options.[7] Increasing wholesale supplies will enhance dealers' ability to meet car shoppers' specific needs.

Untapped Fixed Ops Market Potential

When it comes to maintenance and repair services, dealerships are leaving money on the table: Only 30% of total service visits occur at a dealership.[14] The dealerships that will take maximum advantage of this opportunity will be those that have freed resources from performing wholesale-to-retail-related activities — such as detailing and reconditioning — and allowed them to focus on revenue-generating work orders.

Macroeconomic Trends

An analysis of economic trends indicates that now may be a desirable time to invest in solutions for speeding the wholesale-to-retail process. The automotive industry has a general tendency to run in 10-year peak-to-peak and trough-to-trough cycles.[15] In the last 35 years there has been only one exception: the early 2000s, when many consumers likely relied on home equity to continue purchasing vehicles (see Diagram J).[15] Otherwise, dealers who weathered the financial crisis of 2008 are likely familiar with not only the cyclical nature of vehicle sales, but also the need to adapt to survive. Looking at the long-term pattern of peaks and valleys in vehicle sales, it would appear we are at a crest in the cycle and could soon be seeing an economic contraction that may be exacerbated by: emerging alternatives to vehicle ownership such as ride-sharing, car-sharing, carpooling, improved public transit, urban cycling and telecommuting; and changing shopper demographics, particularly the rise of Millennials as the fastest growing generation of vehicle buyers[7] who are currently frustrated with the dealership experience and are used to the convenience of online shopping.

While the automotive industry is currently strong, dealerships may eventually be faced with increasingly compressed margins coupled with an automotive marketplace of fewer potential purchasers who have more particular preferences. Those that invest in optimizing their wholesale-to-retail processes while times are good will be in a position to gain market share when times get tough.

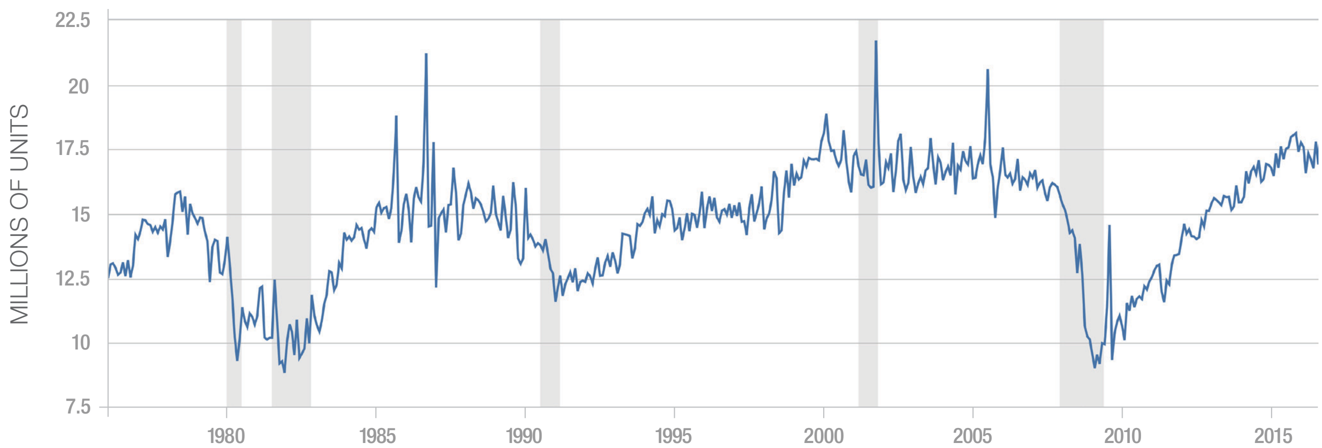
Diagram I[13]

The supply of off-lease used vehicles entering the market has been increasing steadily since 2012.

Diagram J[15]

A CYCLICAL MARKET: WHAT GOES UP MUST COME DOWN

U.S. LIGHT VEHICLE SALES



About Cox Automotive

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[1] Manheim Analysis of 2015 Company Filings of Publicly Traded Dealer Groups — Sales weighted average for ABG, AN, GPI, KMX, LAD, PAG and SAH

[2] Manheim: 2016 Used Car Market Report

[3] 2015 NADA Data Guide

[4] Manheim Vehicle Solutions Study, 2015

[5] Manheim: 2016 Timing of Frontline Readiness Study

[6] vAuto Dealer Customer Data, 2014

[7] IHS Automotive: 2016 Car Buyer Journey Study

[8] For illustrative purposes only

[9] vAuto Performance Data, 2014

[10] Ready Logistics Carrier Data 2016

[11] Manheim Vehicle Solutions Concept Test, 2015

[12] AutoTrader.com Site Statistics, April – June 2015

[13] NADA Data 2015

[14] Cox Automotive: 2016 Maintenance & Repair Study

[15] U.S. Bureau of Economic Analysis, Light Weight Vehicle Sales: Autos and Light Trucks [ALTSALES], retrieved from FRED, Federal Reserve Bank of St. Louis; https://fred.stlouisfed.org/series/ALTSALES, October 2, 2016

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