

Profiting from Used Vehicles in



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No doubt many dealers are entering 2008 with a great deal of caution, maybe even trepidation. And understandably so - financial markets are in turmoil, labor markets are less strong, and consumers have become more cautious as their incomes have flattened, while at the same time, their non-discretionary outlays such as home heating costs, gasoline prices, and mortgage rate resets have risen.

But, by the same token, dealers are by nature (and by necessity) an optimistic lot. They understand the wisdom of a former dealer who said "when your customers hunker down, that's the last thing you want to do." It's true. Hard times demand dealers take positive action, try new initiatives, and tap all possible revenue streams.

In times of economic slowing, one revenue stream that franchised dealers have long turned to, and been duly rewarded by, is their used vehicle department. It's a no-brainer - used vehicle sales are inherently more stable than new, offer greater F&I opportunities, and provide operators with flexibility to respond to any market niche that may be hot. Not surprisingly, given the recent economic climate, franchised dealers have already returned to this tried and true formula. Statistics from NADA show that even as new vehicle profits declined in 2007, used vehicle profits per unit have

risen - and the spread between the two is now at it widest in more than 25 years.

But, let's not deceive ourselves - strong used vehicle profits are not a given. They are built on sound management policies with respect to personnel, pay plans, inventory selection and turn, marketing, and cash flow. And, beyond that, there are two forces driving the used vehicle market that even the best dealers can't control - labor market and credit conditions. Great dealers, however, know how to tack to the changing winds. So, here's our forecast as to those winds.

Auto lenders may not remain immune from the turmoil in the broader credit markets. To date, auto lenders have not been materially impacted by the unrest in the credit markets. That's because auto lending is based on a solid business model with solid

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underwriting principles and the collateral can be quickly liquidated at true market value in the auction arena. Nevertheless, given the stress in the financial markets, it is reasonable to expect that credit availability within the auto sector will become more restrictive in 2008.

Most likely, permissible loan-to-value ratios will be lower and required FICO scores for a given APR will be higher. And, most important, the trend to longer and longer contract maturities will not continue. As seen in the accompanying chart, two-thirds of all subprime auto loans already have contract maturities in excess of 60 months. That's up from less than a third in 2002.

The advice to dealers on how to handle the changing credit situation is an old one - maintain relationships with multiple lenders and make sure they are real relationships where both parties understand the policies with respect to expected volumes, credit profiles, and book-to-look ratios.

The heady days for employment growth are over, but Atlanta will fare better. The average monthly gain in U.S. nonfarm payrolls slowed to just over 100,000 in the second half of 2007 versus gains of 189,000 per month in 2006 and 212,000 per month in 2005. Whether it is anecdotal comments from

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business leaders or often-leading indicators such as initial jobless claims, temporary employment levels and overtime hours, signs suggest that, at best, employment gains will remain modest in the first part of 2008.

In simple terms, it is jobs that create both the demand for used vehicles and the income to satisfy that demand. Therefore, it should be heartening to local dealers that Atlanta's employment outlook appears brighter than that for the overall U.S. In fact, Wachovia's economic team is forecasting that job growth in the Atlanta area in 2008 will be stronger than in 2007.

Although Atlanta has traditionally had an unemployment rate significantly below the national average, that relationship was broken when in the current recovery many major Atlanta employers like Delta, Bell South, and Coca-Cola were still trimming payrolls. And, of course, jobs were lost at both Ford's Hapeville and GM's Doraville assembly plants. In recent months, however, Atlanta's unemployment has once again fallen below the national average a feat made more impressive given that Atlanta is experiencing much faster growth in the potential labor force due to rapid organic, and in-migration, population increases.

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