

How U.S. Dealers Survived the Economic Crisis
Remarks by
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2010 NADA Chairman
Congress FENABRAVE
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Good morning! I want to thank FENABRAVE for the invitation to attend their twentieth annual Congress. And I want to express my gratitude to my friend and fellow dealer Sergio Reze for this invitation.

I have known Sergio for a short period of time but I must tell you, FENABRAVE and its dealer members should feel a great sense of gratitude for the hard work he has undertaken on behalf of the dealers in Brazil. And I am gratified that NADA and FENABRAVE have begun a process of greater collaboration between our two associations.

Today I will share with you some industry statistics, then talk about the strategies U.S. dealers employed to survive what was a difficult two years.

As dealers, we all know that executing on the fundamentals of our business is critical to our success and sometimes our *survival*. Thankfully, many dealers were able to implement strategies that allowed them to survive during the past two years. Let me begin with a short industry overview.



U.S. Auto Industry

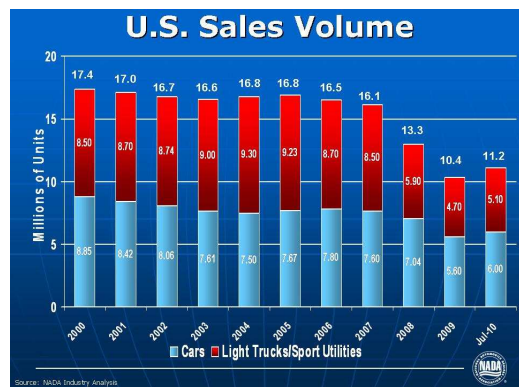
- 15% increase in sales in 2010
- Full year sales between 11.2M – 11.5M
- Retail demand has not fully rebounded
- Ford, Hyundai, Nissan and VW Groups have grown volume by over 20%
- 18,400 dealers operating

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As you can see from this brief summary of the U.S. industry during the first seven months of 2010, the industry has improved markedly since the lows of 2009. But there is still work to be done to improve our overall economy. The auto sector – manufacturing *and* retail – have been two of the most robust parts of the economy.

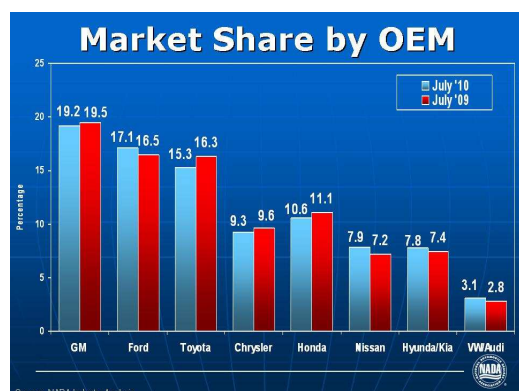
As I am sure many of you have read, Wall Street and our housing industry continue to show weakness – not to mention the 9.5 percent unemployment we are experiencing.

The good news is that sales in 2010 are on track to grow by double digits. Through the first seven months, sales were up 15 percent. We expect that sales will be in the 11.2 to 11.7 million range for the year. Because U.S. consumers continue to be nervous, I have concerns that a full rebound in retail demand is still not on the horizon.



The peak year for the industry was 2000, when we sold 17.4 million units. Even after September 11, the industry sold 17 million units in 2001. It was surprising that after that event we were selling any cars at all. Compare those two years to what we saw between 2008 and 2010: Extremely depressed volumes, well below what was assumed to be a healthy industry of between 14 and 16 million units.

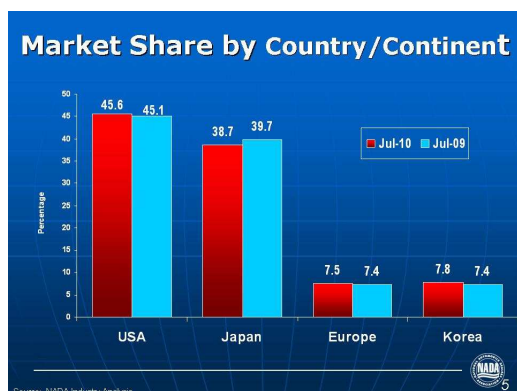
What is encouraging for our industry is that manufacturers, especially the Detroit Three – Ford, GM and Chrysler – undertook significant actions to lower their break-even points to allow for profitability at industry volumes below 11 million. Clearly for GM and Chrysler, the bankruptcy was the impetus for allowing their break-even to fall.



Looking at market share of the major players in the U.S. market, it's no surprise that Ford has been a winner this year. Not having filed for bankruptcy has been of tremendous value to them as they attract customers to the Ford brand. With the introduction of the Ford Fiesta, it is likely that their momentum will continue.

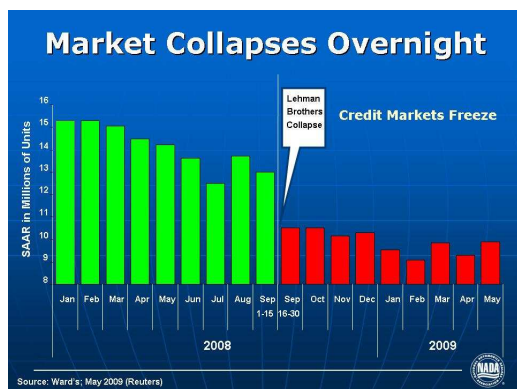
We all know Toyota's challenges, and it shows – they have lost a full point of market share this year. Clearly, the recalls have had an impact on their once-untarnished image.

The big story of the past two years continues to be the success that the Hyundai Group has enjoyed. Hyundai and Kia have grown their market significantly – they have almost eight percent of the U.S. industry. Not so long ago, they were under five percent of the market.



If you look at market share from the perspective of country or continent of origin, it was big news two years ago when the U.S. manufacturers saw their share fall below fifty percent. As you can see, the Detroit Three stand at a 45.6 percent share – up slightly from last July. The European brands have maintained their share year-over-year at 7.5 percent.

As I mentioned earlier, today I want to provide an understanding of the economic crisis and how U.S. dealers survived the turmoil. I want to outline the causes of the “Great Recession” and then highlight the various tactics used by dealers to weather the storm.



The annualized selling rate for most of 2008 was in the 13-million to 15-million range. As the crisis unfolded, you can see that the selling rate dropped to below 10 million units in certain months of early 2009. This collapse in volume had devastating effects on all facets of the industry.

Think about your own dealership volume – it is extremely difficult to take corrective action when volumes collapse so quickly. The demise of Lehman Brothers was the impetus for the free-fall we experienced.

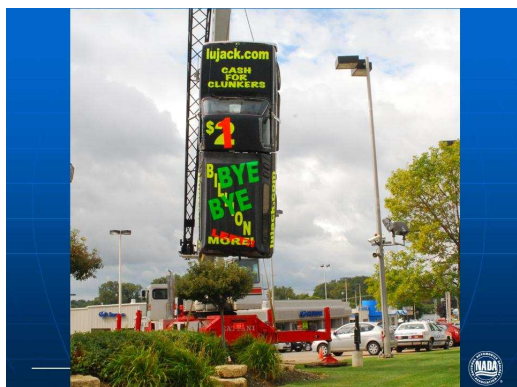
Challenges During Crisis

- Wall Street turmoil
- Tightening of wholesale credit
- Tightening of retail credit
- Lack of consumer confidence
- GM/Chrysler bankruptcies
- Lack of product



The reasons for the economic collapse in America are well-known. The challenges that dealers faced were all as a result of the Wall Street meltdown. Once Wall Street collapsed, we dealers had difficulty with wholesale credit, followed by an almost complete freeze on retail credit.

As wholesale and retail credit improved in the spring of 2009, we were hit with the bankruptcy filings of GM and Chrysler. By the end of the summer of 2009, we faced a different problem: lack of product.



When the U.S. government authorized the \$2 billion Cash for Clunkers program, dealers sold out of most of their inventory. In the course of eight weeks, dealers sold almost 800,000 vehicles.

Impact of Closing Dealerships

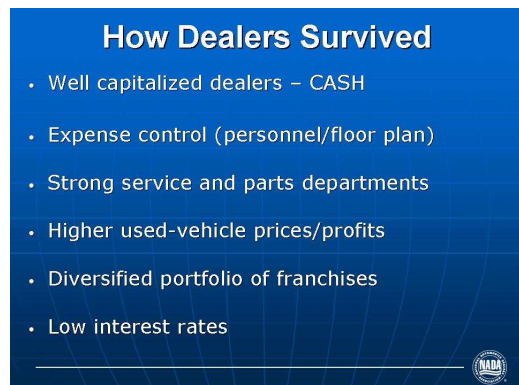
- 100,000 dealership jobs lost
- \$5.3 billion in lost salaries
- \$900 million in employee tax revenue lost
- \$1.9 billion in lost sales tax revenue

**NADA estimates it cost
\$350,000 to close a dealership**



As the chairman of NADA, one of the most disappointing and frustrating aspects of the GM and Chrysler bankruptcies was the impact on the dealers who lost their franchises. Imagine the loss of thousands of jobs, wages and tax revenue.

As dealers, we must constantly remind the politicians and policy makers that drastic actions have severe consequences. In the midst of the great recession, the closing of dealerships added further pain to our economy and our country.



So, how did dealers survive? In my view, five factors allowed dealers in the U.S. to survive.

First, dealerships that were well-capitalized were in the strongest position to survive. As revenues declined rapidly in all departments, it was critical to have sufficient cash on hand to weather the storm. No one knows better than dealers how important cash reserves are – crisis or no crisis.

Second, expense control was critical. As you know, it is never easy to reduce the number of employees we have at our dealerships. But in these challenging times, it became necessary to cut overhead costs, such as personnel and advertising. Just like GM and Chrysler did during the bankruptcy process, we dealers had to establish a “new break-even” for our dealerships. And by doing this, we saved ourselves much-needed capital.

Third, U.S. dealers have enjoyed tremendous success in the service and parts departments. Since the late 1980s, U.S. dealers have adopted strategies to leverage these departments. I do not see American dealers’ dependence on service and parts diminishing anytime soon. In fact, as the market for new vehicles becomes even more competitive, NADA expects American dealers will continue to rely on used vehicles and parts and service to generate revenue.

Fourth, dealers have survived because many of them have a diverse group of franchises. NADA estimates that more than 42 percent of our members have multiple franchises. In difficult times, having multiple franchises is an insurance policy to alleviating the difficulties of a downturn. While no franchise was immune to the challenges, the fact that a dealer owns more than one franchise is critical to weathering any downturn.

Finally, as the recession continued, the Federal Reserve kept interest rates low and that has had a positive effect on our wholesale credit lines and the capital loans that dealers hold. It is also helping credit worthy customer's secure reasonable rates for financing of their vehicle purchases.



For almost 20 years, used-car sales, service and parts have been the profit generators. In 2008, for the first time, the sales in both the new- and used-vehicle departments were in decline. The slight loss in used vehicle sales is attributed to the large swings in the value of used trucks and sport-utilities that year.

Used-vehicle sales were a welcome surprise in 2009; as new-vehicle sales volumes declined, there was a shortage of used vehicles. This simple supply-and-demand problem has led to used vehicle sales prices being 15 percent to 20 percent higher in 2009. This trend has continued into 2010, although at a slower growth rate.



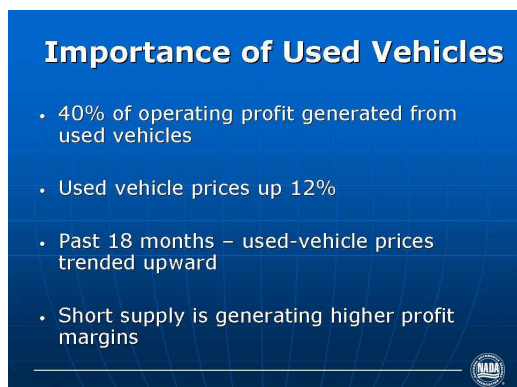
This is the *average* profitability for a dealer. As I pointed out earlier – as sales boomed in the early 2000s, so did profits. Perhaps what is more impressive is that, even in the very difficult years of 2008 and 2009, the average dealer still made money. That proves that we as dealers are capable of making course corrections to ensure we remain in the black.

We can also track return on equity here, which is a measure of how well a company used reinvested earnings to generate additional earnings.



So where is the profitability for U.S. dealers coming from? As we saw previously, all of the profit is coming from three departments – used vehicles, service and the parts departments.

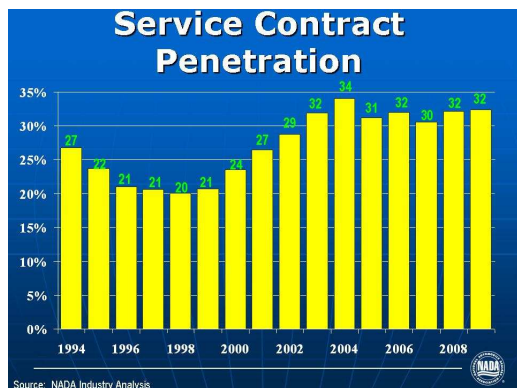
In the early 1990s we began to witness the importance of used vehicles. New-vehicle franchised dealers have sold more than 10 million units for the past ten years. Almost a third of all used vehicles are sold by franchised dealers. This is meaningful volume, and critical to our financial success.



I realize that in Brazil, because of the boom you have experienced with new-vehicle sales, sales consultants and your managers may not be as focused on used vehicles. I urge you to continually remind your managers that used should play a role in adding operating revenue to the dealership. As we all know, there will come a time when you will need this department to be a contributor.

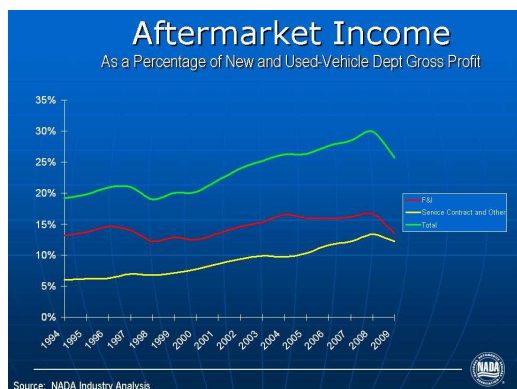
The economic crisis reminded American dealers of the great importance of used-vehicle sales. The new-vehicle sales decline clearly affected used-vehicle sales, but the tight supplies caused retail prices to rise. On average, U.S. dealers are generating 40 percent of our operating revenue from the used vehicle department.

I do not foresee this trend reversing. Until new-vehicle volumes are above 12 million units again, the return from used vehicle sales will be an important part of the financial picture for dealerships. In fact, returns to dealerships on a per-vehicle basis for used vehicles have increased by 39 percent in 2010.



I don't need to dwell on the profit generated in the service department. All of us here know the importance of well-run service and parts departments. What I do want to point out is that there is an opportunity for "extended service contracts." For a long time, U.S. dealers did not do a good job of presenting extended warranties to customers. It was not until manufacturers became more focused on it that dealers began to play closer attention to this revenue opportunity.

I am sure that any dealer in Brazil would love to sell over 30 percent of his customers a service contract. And when you consider that the gross profit on a service contract is \$600 – or about 1,000 Reals – that is meaningful.



There's also value in aftermarket income. When you consider that over 20 percent of operating profit in the new- and used-vehicle departments comes from finance and insurance and service contracts, you realize there is a tremendous opportunity.

Lessons Learned

- Dealer model is not widely understood
- Government/politicians can be helpful but they must be educated
- Dialogue between dealers and manufacturers is vital to mutual success
- State franchise laws continue to be important – balance of power



So what were the lessons we learned during this crisis? In many ways, the lessons we learned in the United States are not unique to us. In fact, I believe that our lessons are transferable to any market in the world.

One thing we found at the peak of the credit crisis is that the dealership model is not widely understood – by government officials, the media or the general public. I was amazed by how many times we had to educate people about how our business works.

For example, most people do not know that dealers own their inventory, that we purchase the cars and trucks from our manufacturers. The common belief is that manufacturers provide the inventory and we as dealers just sell it. This misunderstanding can lead to bad public policy.

I truly believe that government can be our partner and assist us, but it requires one-one-one interaction and a concerted and consistent effort to raise awareness among government officials about auto retailing and how it actually works in the marketplace.

Along with other NADA dealer leaders, I sat in multiple meetings with members of President Obama's administration and had lengthy discussions with his Auto Task Force, which was established to help engineer the changes needed at GM and Chrysler.

This group was made up of Wall Street professionals with expertise in re-structuring businesses. Members of the departments of Treasury, Commerce, Transportation and Energy also provided input.

Our meetings with the Auto Task Force were essential to providing a greater understanding of what dealers do. And it allowed NADA to express concerns about the adverse effects of restructuring plans on dealerships.

As we all can appreciate, regardless of what country you're in, dealers need to ensure that their lawmakers fully understand the vital role dealers play, not only in a country's national economy, but also in their local community.

For example, dealerships in the U.S. helped to fund state and local government programs by collecting more than \$21 billion in sales tax revenue last year.

In addition to meeting with government officials, NADA spends a great deal of time maintaining an ongoing dialogue with all of the manufacturers.

We meet with each of the major manufacturers twice a year to review the results of the NADA Dealer Attitude Survey. Having open communications with the manufacturers proved invaluable as the crisis unfolded.

In numerous meetings with top executives at both GM and Chrysler, we were able to raise dealer concerns, leading to positive results.


Finally, much has been said about the importance of franchise laws, which in the U.S. are in place at the state level. Under normal times, these are enough to protect dealers from unfair terminations at the hands of their manufacturers.

But these were not normal times. GM and Chrysler's restructuring went to federal bankruptcy court, which trumps state law. The result was mass dealership closings.

Nevertheless, franchise laws historically have been pivotal in protecting dealer rights and they will remain so in the future. In any situation other than the bankruptcies, dealers would have been protected by these laws. When meeting with dealers from different parts of the world, I always stress the importance of ensuring protections.

Future of U.S. Market

- Market remains competitive – Fiat, Indians and Chinese will enter market
- New vehicle margins minimal
- Larger brands will all have similar market share – GM, Ford, and Toyota
- Consumer being more rational in purchase decisions - smaller engine displacement/non luxury models



So what does the future look like for U.S. dealers?

The marketplace will remain competitive. Fiat is moving ahead with plans to build vehicles in Mexico for sale in the United States. Mahindra announced in August that they had been cleared to begin selling a small pick-up truck in the U.S. And at some point, the Chinese will arrive!

New entrants in the market likely mean a very competitive new car marketplace and great opportunities for consumers.

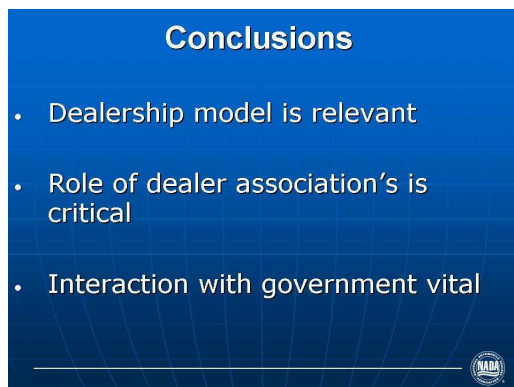
General Motors, Ford and Toyota are expected to all have about the same market share. And Honda could possibly join the other three manufacturers in having a significant percentage of the market.

Perhaps the biggest change we could see is a new type of behavior by consumers when purchasing a vehicle. As this economic crisis has unfolded, I have the sense that consumers are being much more rational about their decision making.

For the consumers who *are* purchasing, there seems to be a new “mindset.” The days of bigger and more horsepower seem to have given way to smaller and more fuel efficient. As an example, the sport utility segment is in significant decline while the crossover utility segment is growing by 20 percent a year. The big benefits of crossovers are their car-like handling and better fuel efficiency.



For all the turmoil, there is evidence that the future for the U.S. market will be positive. It's encouraging that by 2015 we see the industry selling 17.4 million units. After all the misery of 2008 and 2009, it's refreshing to see a forecast above 15 million.



In the past several months, as I traveled, I have drawn a few conclusions about the auto retailing business. First, the franchise system for new-vehicle dealerships is still a viable model.

In more than 60 years of the new vehicle franchise system, dealers have proven they can withstand many difficult challenges. In my lifetime as a dealer and currently as chairman of NADA, I have never witnessed the structural changes that we endured in 2008 and 2009.

I now have even greater respect for dealer associations. In these difficult times, you need a third party that represents the collective interests of the dealers.

NADA has worked hard to help all our dealer members – those who continue as franchised dealers and those who had their franchises taken away.

We worked with President Obama's administration during the bankruptcy process, we have asked for help on behalf of dealers with the Federal Reserve. In late 2009 NADA persuaded the Congress to allow for an arbitration process for dealers who were terminated during the bankruptcies. The result has been over 200 GM and Chrysler dealers have been restored.

In speaking with Sergio Reze and other dealers here in Brazil, I have learned that FENABRAVE has been instrumental in working with the government to ensure that the voice of the dealer is heard. I must tell you that it is critical to have an ongoing dialogue with government. Each of you should take comfort in knowing that your association is working hard to represent your interests with the politicians and policy makers.



As I said at the beginning, I consider Sergio Reze a friend and I am pleased our two associations are working closely together.



NADA was glad to welcome such a large delegation of Brazilian dealers to our convention in Orlando this year. It was with great pleasure that I encourage all of you to attend the 2011 convention in San Francisco next February welcoming many of you to San Francisco next February. I look forward to seeing you there!

Thank you.