

Calculating Real Dealership **PROFIT**

“What we call profits, the money left to service equity, is usually not profit at all. Until a business returns a profit that is greater than the cost of capital, it operates at a loss. Never mind that it pays taxes as if it had a genuine profit. The enterprise still returns less to the economy than it devours in resources... Until then it does not create wealth, it destroys it.” Peter Drucker

Businesses and their employees typically have a very good understanding of their income statement – sales, gross profit, and expenses. However, one of the most frequent questions KEA Advisors gets from dealerships is “I made money, but where is my cash?”

Cash, and the causes of not retaining as much cash as the income a dealership creates, is found on the balance sheet. The ability to combine both income statement and balance sheet knowledge, and more importantly how to manage and improve cash flow, for all employees of the dealership, is important to improving overall cash flow. In addition, the ability to measure the combined performance is vital.

Because of this, KEA Advisors developed the Dealership **PROFIT** measure, along with departmental **PROFIT** measures. The basic calculation is as follows:

Net Income, Annualized
-Cost of Capital

Dealership **PROFIT**

Cost of capital = Total operating assets, less cash, less floor plan liability) x risk premium (20% for the commercial dealership industry)

A positive Dealership **PROFIT** creates wealth.
Anything less than that “...devours resources.”



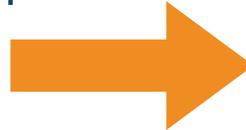
Become The Price Leader In Your Market

The measure that matters? TOTAL Dealership Absorption.

What is Total Dealership Absorption? Total Dealership Absorption is the gross margin generated by your parts, service and used truck departments over your expenses.

115% Fixed Operations Absorption
+ Used Truck Efficiency

130% Total Absorption



**New Truck
Pricing Freedom**

Why is it different? The big difference in traditional conversations on absorption and Total Dealership Absorption is our inclusion of used trucks into the measure. This is an important distinction because used truck departments often have a negative gross profit (and overaged inventory), and that money needs to come from somewhere. For example, if your fixed operations generate enough margin to cover costs, but your used truck department has aged inventory and very little gross profit, the traditional Fixed Absorption measure is going to be telling you the wrong story.

Why does it matter? The aim of every dealer should be to populate their market with as many units as possible to generate profitable parts and service dollars for the dealership. There are solid strategies that can be used to achieve that aim, but all of them become much easier to achieve with more freedom in your new truck pricing. Achieving your target Total Dealership Absorption gives you freedom and flexibility.

What is the target? KEA Advisors recommends **130%** Total Dealership Absorption (fixed operations + used trucks).

How do you get there? The simple answer is “on purpose.” The path to 130% Total Dealership Absorption cannot happen without intentional action on your part. If you want to understand where the gaps in total absorption are today and develop a plan to close them, we encourage you to reach out. We can help you make that happen!

