Written Testimony of John P. McEleney, Chairman

National Automobile Dealers Association

Submitted to the Senate Committee on Commerce, Science and Transportation

For Hearing On

GM And Chrysler Dealership Closures: Protecting Dealers and Consumers

June 3, 2009

Mr. Chairman, Ranking Member Hutchison, my name is John McEleney, and I am the Chairman of the National Automobile Dealers Association (NADA). I am also president of McEleney Autocenter, of Clinton, Iowa. We operate General Motors, Toyota and Hyundai franchises and have been in business for 95 years and now provide jobs for 140 people. Additionally, my family held a Chrysler franchise between 1984 and 2007.

NADA's membership consists of over 17,000 new car and truck dealers in the United States, both domestic and international nameplates, whose independently-owned businesses employ upwards of 1 million "Main Street" Americans. NADA truly is the "Voice of the Dealer" because our association represents over 93 percent of all dealers, regardless of make and model. To put this powerful employment model in perspective, the largest private sector employer in American is Wal-Mart, with 1.3 million employees. Moreover, dealership jobs pay well. The typical compensation for a dealership's employee is more than twice the national average of jobs in the retail sector, and our jobs cannot be outsourced. Even more Americans are employed in businesses that supply goods and services to dealerships. Statistics that document the extent of automotive retailers contribute to our economy at the local, state, and national levels may be found at NADA's website.[1]

Mr. Chairman, on behalf of franchised dealers all across the nation, we commend you and Sen. Hutchison for convening this hearing because we need the help of the United States Senate to ask some key questions about the treatment of dealers, their employees, their communities, and the customers that depend upon these local businesses. Why are dealer reductions necessary at this time? How did Chrysler decide which dealers to terminate? How will the announced dealer reductions enhance the viability of GM and Chrysler? To date, we have received no plausible answers to these most basic questions.

At the outset of my testimony, I wish to emphasize that the overall state of auto retailing is dire. No previous economic challenge except for the Great Depression can compare to what confronts franchised dealers today. The automobile retail industry is highly credit-dependent and, as such, was disproportionately hard hit by last year's financial crisis. Floorplan credit[2], the financing used by dealers to buy new and used vehicle inventory, has contracted dramatically, and even creditworthy dealers are having trouble finding access to floorplan financing. At the same time, we are experiencing the lowest new car sales rate since World War II. Unless and until these larger challenges are resolved, all auto manufacturers and dealers will continue to face problems. In fact, we will not have a meaningful economic recovery in this country without resolving these broader issues, because auto sales historically have constituted 20 percent of all retail spending in the United States.

As the President's Auto Task Force has initiated the restructuring of two of the largest manufacturers in the United States, there has been a significant lack of transparency to this process. As the Chairman of NADA, I have represented dealers in

---

[1] (http://www.nada.org/Publications/NADADATA/DrivingUSEconomy/)

[2] For more on credit and the auto industry, see the attached Appendix, "Credit and the Auto Industry"

three meetings with the President's Auto Task Force as well as in conference calls, and have provided at their request many documents and data. At our meetings with the Task Force, we have repeatedly explained the fact that dealers are not cost centers for manufacturers but rather externalize the manufactures' costs. Dealers are the largest source of revenue for the manufacturers, and to the extent there is "overdealering" in certain areas, the past 50 years the dealer population has declined every year due to orderly consolidations. I elaborate on these points later in this testimony.

NADA has had regular meetings with the manufacturers on a wide variety of matters related to industry relations. During the past year we have met with Chrysler and GM on numerous occasions to discuss the specific submissions that each company made in conjunction with the bridge loans last year and the viability plans this year. Additionally, we have had numerous conference calls on the same issues.

None of Chrysler's submissions to the government prior to the May 14th announcement could have been interpreted to put Chrysler dealers on notice of the scope of the terminations that followed. Similarly, our discussions with Chrysler officials during the past year did not give any indication of these drastic cuts proposed, much less of the onerous terms and conditions. To the contrary, all indications were that dealer reductions would be achieved in the context of the on-going Genesis program which relies principally upon negotiated transactions based on conditions in the local market.

The potential such an orderly transition has degenerated into chaos for 789 Chrysler dealers. These dealerships learned on May 14th that they would lose their franchises within 26 days. Moreover, they were told that the factory would not buy back any unsold inventory of vehicles and parts or any of the factory-specific tools that all dealers are required to buy from the manufacturer. No dealer could possibly have anticipated this egregiously short timetable and these unprecedented terms. After all, the franchise agreement requires the manufacturer to buy back vehicles, parts, and tools. No manufacturer has ever imposed such onerous conditions on terminated dealers. Especially troubling is the fact that during the last few years, some of these terminated dealers were pressured by the manufacturer to build large new retail facilities. Moreover, within the past few months, many of the terminated dealers were strongly encouraged by Chrysler to take additional inventory even when local market demand didn't support this decision.. In short, many of these 789 Chrysler dealers were team players. They did all that was asked of them by Chrysler and in return were stripped of their franchises on less than three weeks' notice with virtually no recourse. In return for their loyalty, they have seen any goodwill in their business evaporate in a matter of days.

Adding insult to injury, *Automotive News* reported just four days after the termination letters arrived that Chrysler was planning to re-enter some of these 789 markets. Since then, we have heard that in some areas prospective new dealers are even touring some of these dealerships targeted for closure. This certainly does not look like a strategy to reduce the dealer count to achieve an efficient rationalization. Rather, this just looks like a strategy to leverage the tremendous unfairness of bankruptcy to force the closure of some dealerships for the benefit of others.

Apparently, at some time during the deliberations of the Administration Auto Task Force, the treatment of GM and Chrysler dealers took a drastic turn for the worse. On March 30, the Task Force rejected GM and Chrysler's own dealer consolidation plans, set forth in their respective "viability submissions" of February 17th, based in part on the fact that task force officials believed their dealer reduction plans did not go far enough or move fast enough. The Auto Task Force's March 30, 2009 Viability Assessment of GM specifically states with respect to brands and dealers that:

> The Company is currently burdened with underperforming brands, nameplates and an excess of dealers. The plan does not act aggressively enough to curb these problems.[3]

Contemporaneous news reports highlighted the same reality:

> New CEO Fritz Henderson says the federal Auto Task Force's rejection of GM's viability plan requires GM to make "deeper and faster" cuts. GM has 60 days to submit a new, more drastic restructuring plan or face bankruptcy. That means GM is pulling forward its plan for dealership consolidation.[4]

Finally this was confirmed in GM's letter on May 14 notifying 1,100 GM dealers of the intention not to renew their franchise agreement beyond October 2010 which read in part "As we have communicated to all dealers, our revised restructuring plan is a result of GM being challenged to move more aggressively and faster in its restructuring efforts".

The Auto Task Force has taken the position that it had not mandated the acceleration of dealer cuts and advised that it was the companies that were initiating the dealer reductions. An Obama administration source told *Politico*," We're happy to listen, but what we will politely say to them is: It's not our job to tell these companies what dealers they should have or, or even how many."[5]

While it is recognized that the Auto Task Force did not identify specific dealer reductions, the question remains why the manufacturers' position changed to mandate the drastic dealer cuts they proposed? What is the objective standard for these actions? Where is the public accountability for these decisions? These rapid dealer reductions will adversely affect many lives and many communities. 789 Chrysler and over 1,100 General Motors dealerships face terminations, and these businesses employ 100,000 middle-class Americans. These people deserve more. The country, currently facing a national unemployment rate approaching nine percent, deserves more. The state and local governments that depend on the dealerships for revenue deserve more. The Federal taxpayers, footing the bill for the restructuring, deserve more.

---

[3] Auto Task Force, March 30, 2009. *GM Viability Assessment – Rejection of GM's February 17, 2009 plan*. "Brands/Dealers: The Company is currently burdened with underperforming brands, nameplates and an excess of dealers. The plan does not act aggressively enough to curb these problems", p. 1.
[4] *Automotive News*, "Henderson's GM speeds up dealer cuts", April 6, 2009
[5] Allen, Mike. "Car dealer cuts coming soon." *Politico*, May 13, 2009

We don't understand how these drastic dealer reductions will increase the viability of GM and Chrysler. Franchised dealerships are independently owned businesses, not the "company owned" stores used by many other industries to distribute their products. The dealer – and not the manufacturer – invests in the land, buildings, facility upgrades, personnel, and equipment necessary to sell and service vehicles. Because of these sizable multi-million dollar dealer investments, manufacturers receive a national retail distribution network at no capital expense and are able to externalize virtually all of the costs associated with the establishment and maintenance of a national retail distribution network for their products.

Absent the franchised dealers, a manufacturer would have to invest billions of dollars to replicate the existing facilities, employees, and retail presence. No manufacturer, much less an automaker in extremis, could possibly assume this burden and hope to remain competitive. No manufacturer would want to assume the risk involved with retailing. For example, if the manufacturers make an unappealing vehicle, the dealers bear the brunt of that mistake and suffer the consequences of unsold inventory. Similarly, the dealers also bear the risk of the deterioration of a prime real estate location and the risk of a local economic downturn.

According to the attached report that we provided to the task force, "The Franchised Automobile Dealer: The Automaker's Lifeline", prepared for NADA by the Casesa Shapiro Group, "far from being a burden to the manufacturer it represents, the automobile dealer supports the manufacturer's efforts by providing a vast distribution channel that allows for efficient flow of the manufacturer's product to the public at virtually no cost to the manufacturer."[6]

Franchised dealers are the largest source of revenue for the manufacturers. In the United States, the dealer body provides 92 percent of GM's revenue. To casual observers this may be a complete surprise, but the explanation is simple. A manufacturer does not sell cars to consumers. A manufacturer sells cars to a dealer, and the dealer sells the car to a consumer. Moreover, because the manufacturers control large streams of payments to the dealer body – all of which are non-interest bearing payments made in arrears for products already delivered or services already performed – the manufacturers can simply use cash management techniques to achieve "cost of money" savings that would easily offset these minimal operational expenses. In the aggregate, the manufacturers can use this "float" to earn millions of dollars. And there are a number of purchases that dealers are required to make – including signs and specialized tools – on which the manufacturers actually make a profit. The "cost of money" savings alone are likely to offset the minimal administrative expenses associated with the direct support of the dealer network.

The rapid and destructive dealer reductions will erode market share. Dealers have deep roots in the community and have helped provide manufacturers with long-term

[6] "The Franchised Automobile Dealer: The Automaker's Lifeline." Casesa Shapiro Group, November 26, 2008 (Attached)

customer relationships that create brand loyalty and maintain customer convenience. Therefore, reductions in dealer numbers will not only cut manufacturer revenue but also market share. Dealer closures must be done carefully to maintain the manufacturer's viability. "We had 13,000 dealers 18 years ago, so we've already cut that in half," Mark LaNeve, GM's North American President, said at this year's North American International Auto Show in Detroit. "We don't want them to close all at once because we figure we lose sales for 18 months after a dealership closes until other dealers pick up the business."[7]

The purported administrative savings from reducing the dealer count will not materialize. Since the principle purpose of the franchised dealer network is to outsource costs, the manufacturers incur very little direct costs related to the dealer network. Several years ago, a General Motors executive observed that the sale of 10 cars per year by a dealer would cover the automaker's operational expenses (field personnel, etc.) associated with that dealer. Therefore, few savings are likely to be generated from dealer reductions.

- Marketing and advertising costs are not likely to be reduced because of a reduction in the dealer network**.** Individual dealers, not the manufacturer, pay for state and local marketing and advertising. Also considering the initial loss in market share resulting from dealer closings, marketing efforts will likely have to be increased in the short run.

- Manufacturer retail incentive costs are determined by the number of vehicles being sold, not the number of dealers in a given market**.** The manufacturers provide various incentives (i.e. rebates) for dealers and consumers to stimulate vehicle sales to clear inventory or increase market share for a particular vehicle. The only way for these costs to be reduced would be a reduction in total vehicle sales.

- Manufacturers require various dealer employees to undergo training, but the dealer pays for these costs, not the manufacturer**.** The dealers will continue to absorb these costs regardless of the number of dealers.

- Destination fees are standardized, so it is highly unlikely that manufacturers' distribution costs will be reduced**.** The manufacturer sets the distribution fee. And unless the manufacturer plans on exiting an entire geographic region, shipping costs will not significantly change. If such a drastic consolidation even did occur, the manufacturer would immediately suffer losses in market share, causing the per unit distribution cost to rise.

- Manufacturer's interest expense will not decline, since the expense is related to the number of vehicles financed, not the number of dealers financing the vehicles**.**

[7] *Bloomberg News,* "Small cars aren't selling as well, GM official says; Fuel prices send buyers back to SUVs, pickups", January 14, 2009.

Most manufacturers provide some financial incentives to offset the initial costs of dealer borrowing (for inventory, parts, etc.). Since fewer dealers would have to finance greater numbers of vehicles to keep sales constant, the remaining dealers would expect to continue to receive the per unit incentive to offset the additional risk of financing a larger inventory.

- The dealer network requires very little incremental costs**.** With modern electronic communications, the costs needed to maintain the dealer network are minimal, as are the potential savings with reducing or even eliminating dealers.

- Simplistic attempts to compare the number of dealerships or the "throughput" of new car sales at GM and Chrysler dealerships to Toyota dealerships are invalid. The task force is only focused on new car sales. Yet, there are 66 million GM vehicles on the road today and 33 million Chrysler vehicles versus 22 million Toyota vehicles. Consumers need to service and repair these vehicles, and domestic brand dealerships serve more cars per location than international nameplate dealerships. Drastically reduced dealers mean consumers will experience higher prices from reduced competition and greater inconvenience from reduced service facilities. Similarly, GM and Chrysler serve far more rural areas than Toyota and – as a direct result – enjoy a higher market share in rural areas.

An orderly, market-based consolidation of the dealer network has been underway for more than 50 years. For decades the number of dealerships in the U.S. has been shrinking at a consistent pace, dictated by market conditions and accelerating during a recession such as today. In 1949 there were almost 50,000 dealerships and by 1970 that number was 30,800. During that timeframe virtually all of these held domestic franchises. In 1987, there were 25,150 new-car dealerships; by the end of this year, we expect that number to have dropped below 17,000.

The sharp reductions in domestic dealerships have occurred despite the fact that the size of the nation's fleet keeps increasing. The number of vehicles in operation rose from approximately 125 million in 1976 to almost 250 million in 2007. More important, the majority of the vehicles in operation today have domestic nameplates. Therefore, the number of domestic vehicles in operation per domestic dealership continues to rise. Even without the drastic reductions that GM and Chrysler seek to impose, the number of GM and Chrysler vehicles on the road today per dealership is at an all time high.

While market forces have operated – and will continue to operate – to reduce the number of dealerships, there are important counterbalancing factors to consider. The foremost of these are the convenience and competition that consumers receive from an extensive dealer network. Intra-brand competition is very important to consumers. Indeed, the most intense competitor for, say, an individual Ford dealer is the nearest Ford dealer. Therefore, any precipitous decline in the size of the dealer network of any manufacturer could dramatically reduce competition for the sale and service of vehicles.

For 100 years, the franchise system has provided a strong auto retail network for consumers, dealers, and vehicle manufacturers alike. All 50 states have enacted motor vehicle franchise laws to inject balance in the inherently one-sided economic relationship between a dealer and the manufacturer and to provide consumers a reliable, convenient, and competitive retail network for automobiles sales and service. The state franchise laws guard against a manufacturer unilaterally terminating a dealership without cause and unilaterally threatening to put the same brand on every corner. A typical state franchise law requires a manufacturer to show good cause in order to terminate a dealer agreement, provides a framework for determining a fair value of the franchise terminated, establishes basic rights of succession from generation to generation, and sets out a definition of relevant market area to preclude unfair proliferation of dealerships. Numerous courts, including the United States Supreme Court, have upheld the constitutionality of various state franchise laws.

The state franchise laws have provided a rational framework for consolidation and reduction of dealerships and have not prevented the termination of brands. Within the past sixty years, the number of dealerships has declined steadily from almost 50,000 in 1949 to 17,000 today. Even with the state franchise laws in full effect, the manufacturers have combined brands under one roof at the dealership level via channeling agreements, eliminated brands altogether, and terminated individual dealers.

The unprecedented evisceration of state franchise laws under the guise of a structured bankruptcy is one of the most disturbing aspects of the treatment of GM and Chrysler dealers. This disregard of state franchise laws is threatening the economic stability of communities and eroding the national infrastructure essential to the recovery of troubled manufacturers. In the case of Chrysler, we have a window to the future unless corrective action is taken: closed businesses, terminated employees, increased foreclosures, and idle real estate, thereby deepening the current recession and threatening even the dealerships that the manufacturers would designate for survival.

The more we learn of the specific facts and circumstances of the Chrysler closures, the more we are concerned that this forced bankruptcy is being used to circumvent long-standing state laws. The fact that the Administration is part of this process is especially surprising, because on May 20, 2009, the Obama Administration released a memorandum that stated as the general policy of the Administration: “preemption of State law by executive departments and agencies should be undertaken only with full consideration of the legitimate prerogatives of the States and with a sufficient legal basis for preemption” Moreover, according to the memorandum, “The Federal Government's role in promoting the general welfare and guarding individual liberties is critical, but State law and national law often operate concurrently to provide independent safeguards for the public.”

In addition to protecting broad public interests, the state franchise laws actually ensure to the economic benefit of the manufacturers as well. Dealer investments in the retail network are premised on the existence of franchise law protections. If the franchise laws were not present to protect those investments, the investments would carry more risk. And that risk, in turn, would command a risk premium. Indeed, publicly-traded auto retailers routinely disclose the possible repeal of state franchise laws as a risk factor in their public filings. If those laws were in fact to be removed, that risk would become a reality and the capital investment markets would respond accordingly. Existing capital would seek safer havens, and the cost of attracting new capital would rise. While this would be very visible in the public capital markets, the same phenomenon would play out in the private capital arena as private dealers make decisions where to place their resources.[8] And these increased costs would have to be paid somewhere in the overall industry value chain. Thus, far from saving manufacturers anything, the removal of the state franchise laws would actually raise their costs of operation.

In conclusion, rapid dealer reductions increase unemployment, threaten communities, and decrease state and local tax revenue without any material corresponding decrease in the automaker's costs. We don't understand why hundreds of small businesses are being forced out of business and under such onerous terms with little accountability. We urge the following in the case of Chrysler: The Executive Branch should provide sufficient debtor-in-possession financing to enable Chrysler to buy back the parts, inventory and manufacturer-specific tools from the terminated dealers. This is standard practice in the industry. Second, the terminated Chrysler dealers need more time to make an orderly transition. No manufacturer has ever imposed such onerous terms and such an onerous deadline. Third, franchise laws of the 50 states should remain intact and apply with full force and effect once Chrysler emerges from bankruptcy. The bankruptcy courts should not be used to circumvent state franchise laws. With respect to GM, we urge that the mistakes of Chrysler not be repeated.

Thank you for holding this important hearing, and thank you for the opportunity to testify.

[8] Similarly, dealers with franchise agreements that have limited durations – e.g., five or six years – could find it difficult (or more expensive) to convince finance sources to loan them money absent the fact that most of the state franchise laws protect non-renewals in the same way they protect against unwarranted terminations.

November 26, 2008

The Franchised Automobile Dealer: The Automaker's Lifeline

"Far from being a burden to the manufacturer it represents, the automobile dealer supports the manufacturer's efforts by providing a vast distribution channel that allows for efficient flow of the manufacturer's product to the public at virtually no cost to the manufacturer."

Prepared for:

National Automobile Dealers Association

CASESA SHAPIRO GROUP

Executive Summary

The independently owned and independently financed franchised automobile dealer network is a critical asset to the auto manufacturers. U.S. auto dealers have $233.5 billion invested in their businesses. This capital is supplied by 20,700 independent dealerships that employ and train over 1.1 million people.

The dealer body is not owned by the manufacturer but is independent and self financed. It serves as the link between the assembly line and the consumer. Far from being a burden to the manufacturers they represent, dealers act as an extension of the manufacturer. They support the manufacturers' efforts by providing, at virtually no cost to the manufacturer, a vast distribution channel that allows for efficient flow of product to the public.

The relationship between the dealer and manufacturer is mutually beneficial. The dealer's significant investment allows the manufacturer to spend its resources on research and development of product while the dealer spends its resources on sales, marketing, and customer handling. Each group benefits from the other and neither could afford all the expenses of the total value chain.

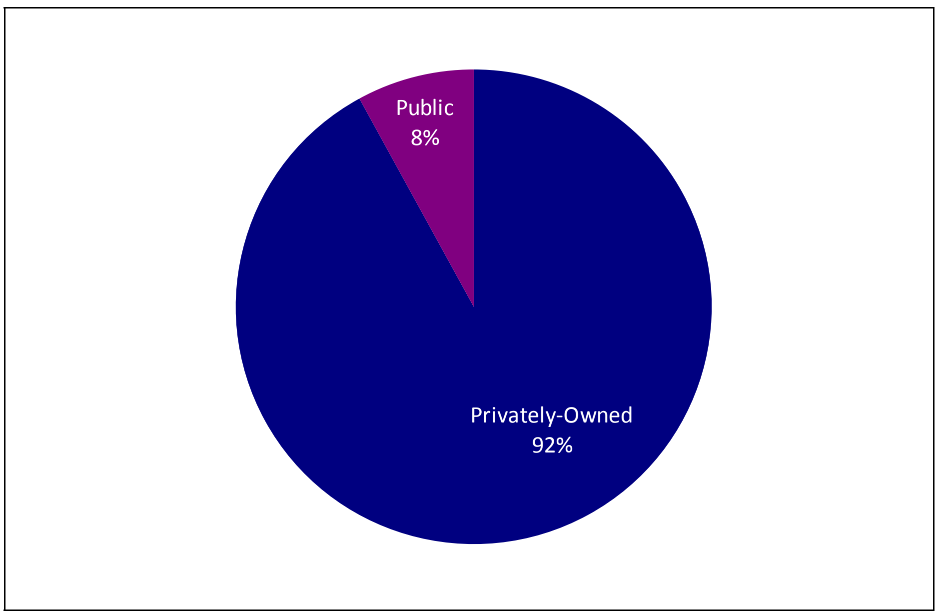
Overview of US Auto Retailing

Virtually all new cars and light trucks bought in the U.S. are sold through franchised dealers. Dealers are independently owned, and combined, represent the largest retail business in the U.S., with approximately $693 billion in revenues in 2007. Franchised dealers employ over 1.1 million people, comprise nearly 20% of all retail sales in the U.S., and, in total, pay billions annually in state and local taxes.

Dealers are Independent Businesses

The nation's 20,700 independent franchised new car dealerships comprise an industry that is fragmented and largely privately held, with private ownership accounting for 92% of the market (Chart A). ***The franchised dealership is a business independent of the auto manufacturer, is self financed, and serves as an extension of the manufacturer. Far from being a burden to the manufacturer it represents, it supports the manufacturer's efforts by providing a vast distribution channel that allows for efficient flow of the manufacturer's product to the public at virtually no cost to the manufacturer.***

Chart A: Dealership Ownership in the U.S.



Source: Merrill Lynch

Dealers Play a Complex and Essential Role

The franchised dealership system in the U.S. is the independent link between the manufacturer's assembly line and the consumer and its functions include, but are not limited, to the following:

- Selling the product and providing information for consumers
- Holding vehicle and parts inventory for a push oriented manufacturing system
- Performing service and providing parts to fulfill manufacturer warranty obligations
- Handling product safety recalls

- Facilitating the exchange of used vehicles
- Arranging financing for consumers
- Supplying capital for new showrooms and service facilities
- Creating advertising and marketing programs targeting local markets
- Providing market feedback to the manufacturer
- Training employees as required by the manufacturer

Dealer Investment on Behalf of Automakers

In filling their essential role as the link between the assembly line and the consumer, franchised dealers make large investments, incur substantial expenses, and bear considerable financial risk that *otherwise* would be borne by the manufacturer. The scope and magnitude of these financial commitments is discussed below.

1. Dealer Investment

Franchised dealers have $233.5 billion invested in their businesses, or an average of $11.3 million per dealership. The main components of this investment can be broken down into the following categories:

a. Facilities and Land

Most individual auto dealerships require several acres of land, which the owner must purchase or lease. Manufacturers require that the owner build or maintain a facility that houses a vehicle showroom and a service and parts center, along with all related customer and employee amenities. The business is real estate intensive. Casesa Shapiro Group estimates, conservatively, the average dealership has approximately $2.5 million invested in land, buildings, furniture, fixtures and equipment.

b. Inventory

In lieu of the auto manufacturers having to do so, dealerships maintain a large physical inventory of new cars. Typically, a dealership will hold a 60-90 day supply of new cars. The average dealership has approximately $4.9 million invested in new car inventory. This number nationally is $101.3 billion.

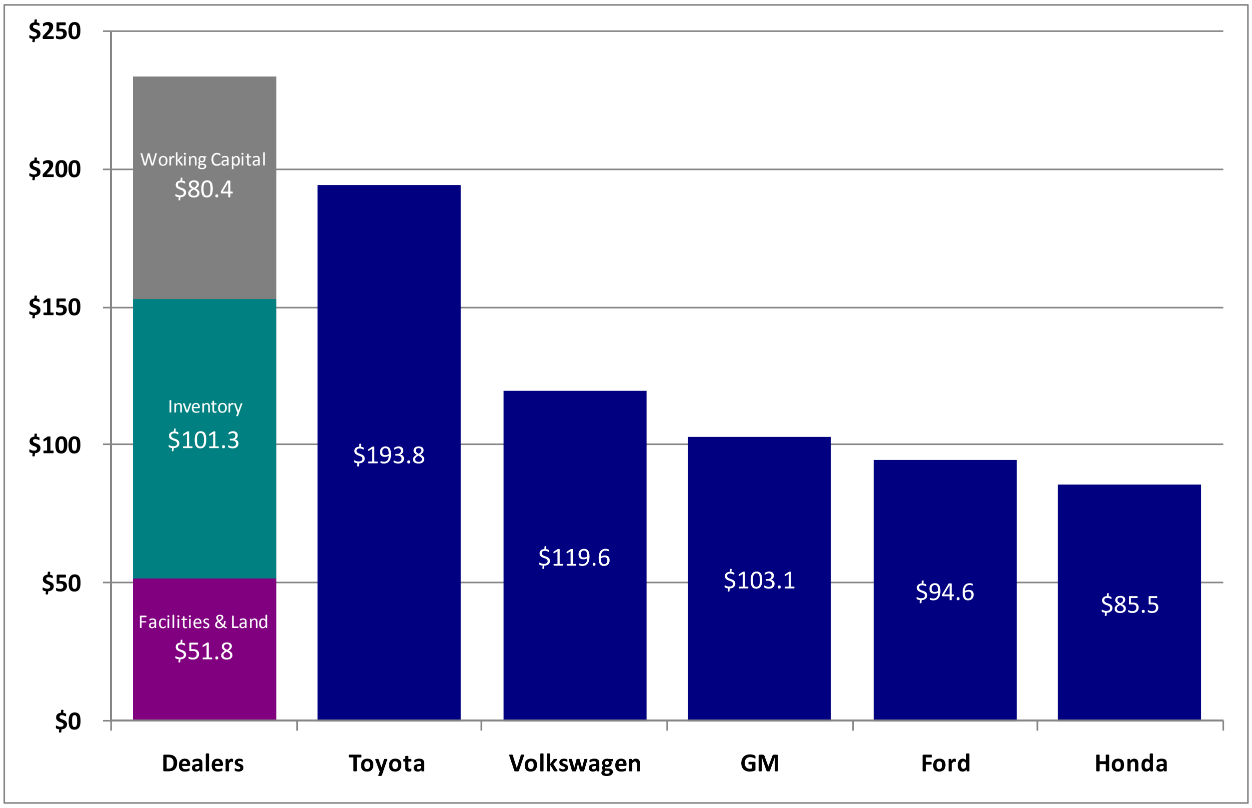
c. Working Capital

Manufacturers dictate specific working capital requirements, which are significant. For example, manufacturers typically require that dealers carry net working capital investment equal to two months of parts inventory value, new and used inventory value, and other expenses. In addition, more capital is needed to fund receivables due from manufacturers, customers, and finance companies. The average dealership needs approximately $3.9 million in working capital and nationally dealerships have $80.4 billion invested in working capital.

In total, U.S. franchised dealers have more capital invested in their businesses than the world's largest automakers, as shown in Chart B.

<u>Chart B: Investment of the U.S. Franchised Dealer Body vs. Total Industrial Assets of Major Automakers</u>

$Billions



Source: NADA Industry Analysis for September 2008; company reports for latest fiscal year; Honda and Toyota fiscal year ends March 31.

2. Operating Expenses

In 2008, dealers are expected to deliver approximately 13.5 million new vehicles to customers. In doing so, they will incur approximately $80.8 billion in expenses.

a. Personnel Expense

The largest category of expense is for personnel, which is estimated at $36.5 billion for 2008.

b. Sales Related Expense

In 2008, dealers will spend approximately $7.3 billion advertising manufacturers' products, or more than $20 million per day. These expenditures are in addition to what the manufacturer spends to advertise its product, thus augmenting the automakers' marketing efforts. Dealers also spend $329 million annually to train sales personnel to remain knowledgeable about manufacturers' products. In addition, it is estimated that dealers spend $873 million annually on regulatory issues such as Truth in Lending and Graham Leach Bliley Act/privacy compliance.

c. Service and Parts Related Expense

Dealers incur costs to train service technicians who repair and maintain customers' vehicles. Training expense is ongoing as the manufacturer continually introduces new models and technologies. In addition, dealers must also comply with changing OSHA and EPA requirements. The dealer body spends $423.8 million per year to keep its service staff proficient, or about $20,473 per dealership.

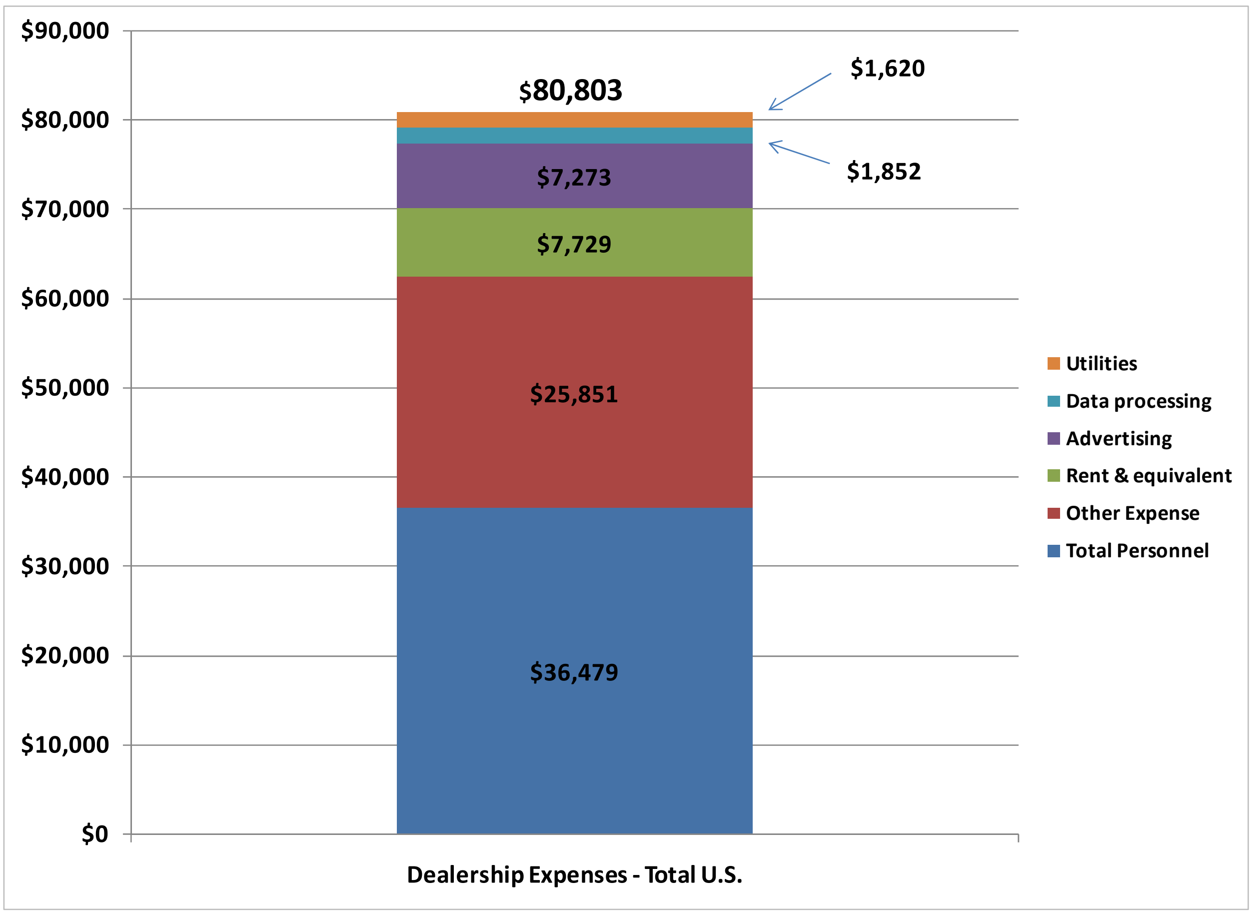
d. Inventory Expense

Aggregate new vehicle inventory carrying costs are $890 million or $42,995 per dealership on an annual basis.

Chart C below illustrates aggregate dealership expenses for dealerships in the U.S. Chart D shows the average pre-tax net margin for dealerships in the U.S., which is etimated to fall to 0.8% in 2008.

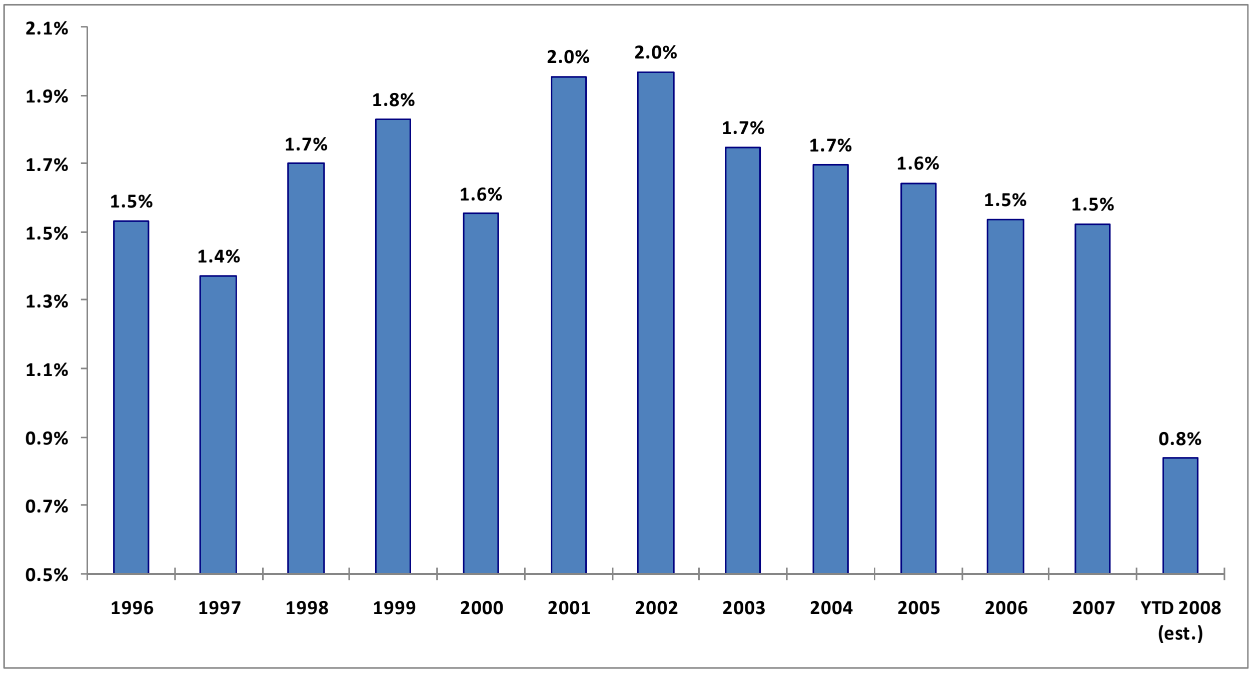
Chart C: Aggregate Dealership Expenses for Dealerships in the U.S.

$millions



Source: NADA Industry Analysis

Chart D: Pre-tax Net Margin for Dealerships in the U.S



Source: NADA Industry Analysis; Casesa Shapiro Group estimates

Automakers Have Externalized Significant Risks to Dealers

In addition to making large investments and incurring substantial expenses to operate, dealers shield the manufacturer from various risks.

1. Multi Million Dollar Inventory Risk

The manufacturer invoices the dealer for a new vehicle when it ships the vehicle from the plant, not when the vehicle arrives at the dealer. Often, time from invoicing to physical receipt can take two weeks, or longer. The dealer bears the carrying cost during this delivery period. On the other end of the spectrum, the dealer bears the risk of aging inventory. While the manufacturer may provide assistance from time to time in the form of rebates and incentives, the dealer takes the risk that the vehicle may sell at a loss. The average dealer has approximately $4.9 million of new car inventory at risk.

2. Financing Risk

Most dealers finance their vehicle inventory through a finance facility called a floorplan. Most dealer principals are personally responsible for this floorplan liability. Risks here are twofold: a floorplan lender may rescind its commitment, leaving the dealer to find a new lending source or being forced to pay off the note, a potentially devastating outcome as dealers rarely have enough cash to pay off such a large obligation. On the consumer side of the equation, dealers are at the mercy of the consumer lending market. Should lenders cease to lend, or tighten their lending standards, the dealer's ability to sell his or her inventory is greatly diminished.

3. Receivables Risk

Receivables due from the manufacturer include vehicle holdback (essentially a margin payment), vehicle incentives, and warranty reimbursements. While the dealer must fund payment timing differences through working capital, the dealer is at risk in the case of a manufacturer bankruptcy. Receivables due from the consumer include payment for labor and parts for service work performed but not yet paid. The dealer is also at risk for receivables from financial institutions funding the consumer's purchase of the vehicle.

4. Real Estate Risk

Dealers have large investments in land and facilities. Often, these facilities are single purpose and cannot be used for occupants other than auto dealerships. In addition, manufacturers often require dealers to undertake substantial renovation projects to their facilities for branded image programs. Manufacturers often wield a velvet hammer, attempting to use a dealer's refusal to embark on an image program to prevent the dealer from sharing in certain incentives available to those who have undertaken the program. Should a particular manufacturer's sales decline, or should a manufacturer exit the market, the return on capital invested in these programs is often poor or worse.

Importance to Local Communities

Car dealerships are local businesses and provide significant sales tax revenues and employment opportunities to the communities in which they operate. Nationwide, car dealerships provide employment for 1,114,500 people and pay billions annually in state and local taxes. In addition, on average, each dealership makes $25,600 in charitable contributions to its community.

Appendices A and B attached provide some context on a state by state basis of the prevalence and reach of these businesses. At a more local level, a typical dealership geographic profile may look as follows:

Table A: Estimated Economic Impact of Dealers, by Representative Town/City

	Population	Estimated No. of Dealers	Estimated Employment	Estimated Investment
Newark, OH	47,176	9	486	$101,700,000
Greensboro, NC	247,193	90	4,860	$1,017,000,000
San Jose, CA	939,899	220	11,880	$2,486,000,000

Source: Casesa Shapiro Group

Conclusion

U.S. franchised auto dealers have invested $233.5 billion in their independent businesses. This investment represents more capital than the total industrial assets of any of the world's largest automakers. These businesses employ over 1.1 million people, are supportive of their local communities, and pay billions annually in state and local taxes. They deflect certain financial risk from the manufacturers by putting their own capital at risk. The dealers' enormous investment allows the manufacturer to spend its resources on research and development of product while the dealers spend their resources on sales, marketing, and customer handling. Neither group alone could afford all the expenses of the total value chain. Dividing the value chain rationalizes the process. Automakers spend their resources efficiently on manufacturing and dealers spend their capital efficiently on serving the consumer. The independent franchised dealer body is the lifeblood of the automaker. While the retail consumer is the dealer's customer, the dealer is the manufacturer's only customer.

Far from being a burden to the manufacturer it represents, the automobile dealer supports the manufacturer's efforts by providing a vast distribution channel that allows for efficient flow of the manufacturer's product to the public at virtually no cost to the manufacturer.

Appendix A: Estimated Number of New Car Dealership Employees in 2007, by State

	Total Employees	Avg. number per dealership
Alabama	16,471	48
Alaska	2,292	60
Arizona	29,182	114
Arkansas	8,712	33
California	133,721	84
Colorado	17,076	60
Connecticut	14,388	45
Delaware	4,022	62
DC	32	32
Florida	76,508	81
Georgia	33,858	56
Hawaii	5,105	77
Idaho	5,842	47
Illinois	43,336	46
Indiana	21,778	42
Iowa	12,020	33
Kansas	10,072	39
Kentucky	13,072	44
Louisiana	18,210	54
Maine	5,350	37
Maryland	24,131	67
Massachusetts	23,400	49
Michigan	36,258	48
Minnesota	19,500	45
Mississippi	9,460	39
Missouri	21,603	44
Montana	4,280	32
Nebraska	6,584	31
Nevada	11,025	93
New Hampshire	7,122	42
New Jersey	32,152	56
New Mexico	7,458	53
New York	49,122	44
North Carolina	32,828	47
North Dakota	3,196	33
Ohio	40,937	43
Oklahoma	19,979	67
Oregon	14,092	51
Pennsylvania	50,694	44
Rhode Island	3,308	53
South Carolina	15,042	46
South Dakota	3,480	30
Tennessee	22,121	53
Texas	86,828	65
Utah	9,340	61
Vermont	2,783	29
Virginia	33,094	60
Washington	23,317	61
West Virginia	6,227	37
Wisconsin	21,633	36
Wyoming	2,460	35
Total US	**1,114,501**	**53**

Source: NADA Data, 2008 Edition

Appendix B: Relationship of New Car Dealerships to Total Retail Trade in 2007, by State

	Dealer payroll as % of total retail payroll in the state	Dealer employees as % of total retail employment in the state
Alabama	12.9%	7.0%
Alaska	11.5%	6.8%
Arizona	15.2%	8.4%
Arkansas	12.7%	6.7%
California	13.9%	7.9%
Colorado	13.6%	7.3%
Connecticut	14.0%	8.0%
Delaware	15.2%	8.2%
DC	1.4%	0.7%
Florida	15.1%	7.9%
Georgia	13.8%	7.4%
Hawaii	12.0%	6.2%
Idaho	12.6%	7.3%
Illinois	13.8%	7.6%
Indiana	12.9%	7.0%
Iowa	13.3%	7.3%
Kansas	13.2%	7.2%
Kentucky	11.9%	6.4%
Louisiana	14.5%	7.5%
Maine	11.8%	6.6%
Maryland	14.7%	8.3%
Massachusetts	12.7%	6.8%
Michigan	15.1%	7.7%
Minnesota	12.3%	6.8%
Mississippi	12.4%	6.4%
Missouri	13.9%	7.3%
Montana	12.1%	7.0%
Nebraska	12.6%	6.9%
Nevada	14.9%	7.7%
New Hampshire	13.9%	7.7%
New Jersey	13.4%	7.2%
New Mexico	14.0%	7.8%
New York	10.5%	5.9%
North Carolina	13.8%	7.5%
North Dakota	14.0%	8.0%
Ohio	12.9%	7.3%
Oklahoma	14.6%	7.7%
Oregon	13.1%	7.4%
Pennsylvania	13.8%	8.0%
Rhode Island	11.9%	6.5%
South Carolina	12.1%	6.6%
South Dakota	13.3%	7.5%
Tennessee	13.4%	7.3%
Texas	14.6%	7.9%
Utah	11.6%	6.2%
Vermont	12.9%	7.5%
Virginia	14.6%	7.9%
Washington	12.1%	7.2%
West Virginia	12.7%	7.4%
Wisconsin	12.9%	7.6%
Wyoming	13.5%	7.4%
Total US	**13.4%**	**7.3%**

Source: NADA, 2008 Edition

Sources

Casesa Shapiro Group
Ford Motor Company
General Motors Corporation
Honda Motor Co.
Merrill Lynch & Co.
NADA Industry Analysis
Toyota Motor Co.
Volkswagen AG

Casesa Shapiro Group

787 Seventh Avenue, 6th floor, New York, NY 10019
212.492.7627 Tel 212.492.7021 Fax

Appendix B: Credit and the Auto Industry

Credit is the lifeblood for every franchised dealer, and the credit markets are still not functioning properly. Since more than 90 percent of vehicle purchases are financed, adequate retail credit is essential to facilitate auto sales. Additionally, dealers, like many other businesses, need sufficient working capital to maintain cash flow. Finally, floorplan credit – the financing dealers use to buy new and used vehicle inventory – is essential. These continuing problems are not limited to dealers with domestic nameplates and are not limited to any one region of the country.

Floorplan lending capacity has contracted dramatically during the past nine months. Most of the captive finance companies have reduced their floorplanning activity, in large part due to liquidity constraints. At the same time, several regional banks have completely eliminated this line of business, and many of the remaining floorplan lenders are not adding any additional dealers. Even creditworthy dealers are having trouble finding access to any floorplan financing or the financing available to them is being offered on terms that are not competitive and not commensurate with the risk to the borrower. In sum, a fear-based retrenchment in floorplan lending is underway throughout the auto industry despite the fact that the typical portfolio of floorplan loans (1) has an excellent repayment history, (2) is highly collateralized, and (3) has historically carried a AAA rating when securitized.

Moreover, the lack of consumer confidence is a persistent problem, despite the fact that there has never been a better time to buy a new car. The quality of vehicles being sold by our highly motivated retailers is better than ever, with great incentives; but the public is not shopping. The annualized rate of new vehicle sales for 2009 is hovering around 10 million. Even the replacement rate due to salvage is estimated to be at least 12 million per year.

The drop in sales came in response to a variety of factors. Last summer, we had to deal with a massive spike in gasoline prices which dramatically disrupted consumer demand. For several months, the amount of discretionary income and the fear of sustained gasoline prices in excess of $4.00 per gallon economy altered consumer preferences so rapidly that the market could not adjust. As the economy deteriorated last fall, consumers naturally were less likely to commit to big ticket purchases. Then came the near meltdown of the nation's credit markets, and highly publicized problems within the automotive industry. The events of the past year truly have been the perfect storm in auto retailing.