

The National Alliance of Buy Here Pay Here Dealers

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Differing BHPH Strategies in the Current Economic Environment *By Kenneth B. Shilson, CPA*

As I survey buy here, pay here dealers around the nation about their mid-year 2009 results I discovered that many are approaching the current economic environment with differing strategies. During the last several years, competition has been fierce! This has prompted many operators to be very aggressive in underwriting new business. Many lowered or deferred down payments or reduced repayments in order to capture more customers. Although these approaches added new customers they also consumed significant amounts of cash flow and capital. In 2008, the average cash in deal exceeded \$5,000.00 for the first time in the last 10 years, according to the industry benchmarks.

The Supply of Capital to the Automotive Funding Market

The current economic environment has severely curtailed the supply of capital to all industries. The buy here, pay here industry has seen banks and other financial institutions reduce loan advance rates, reduce available credit lines, increase interest rates and, in some cases, decline renewing performing loans! In discussing these trends with capital providers they have indicated that the supply of capital to the automotive industry, including BHPH, will be reduced in the months ahead. They perceive that economic uncertainties require operators to maintain more financial flexibility by reducing their debt and by increasing equity. If an operator does not have cash reserves on hand (very unlikely in the BHPH business) then he must either loan his operation more money or make an additional capital contribution in order to make an immediate debt reduction.

How Are Lenders & Operators Reacting to the Current Funding Environment?

In such situations, the operator may face considerable economic stress. If an immediate debt reduction is not required, but the lender wants a reduction in the future, operators are reacting in different ways as follows:

1. Some are cutting overhead and expenses to increase cash flow which can then be used to repay future debt.
2. Some are reducing sales volumes by tightening underwriting criteria. This reduces the amount of money being “put on the street” but likely will also reduce overall size of the portfolio.
3. Some are changing their business model by reducing vehicle acquisition cost or by increasing down payments or repayments. However, selling a cheaper car with the same origination term will likely increase losses in the future.
4. Other operators are trying to refinance or obtain additional subordinated debt.
5. Some are considering a “sell-off” of a portion of their existing portfolio with the proceeds to be used to reduce debt.
6. Other options include lot closures, consolidation, sale or merger.

Competition for Quality Credit is Ahead

Although none of the above appear desirable, the goal to reduce the amount of leverage in the industry is a positive one. As difficult economic times continue, better-quality credit customers are entering the market. The competition for these customers has been greatly reduced by a reduction in the subprime lending market. Operators who can “free up” additional cash flow will be able to capitalize on these opportunities. Further, as better-quality credit customers enter the market it is hoped that operators will improve their deal economics by increasing downpayments and repayments. However, many operators will have to learn how to attract and close these “better customers” as they expect different treatment.

Pain Before Gain in the Future

In summary, the current environment is a lot like exercise: there has to be some pain before there can be some gain! The decisions operators face today will have significant implications for years to come. Therefore, future strategies should be carefully evaluated in conjunction with networking and dealer education. Costly trial-and-error mistakes must be avoided as it appears there is not enough money to spread around! Good luck.

Kenneth Shilson, CPA, is founder of the National Alliance of Buy Here, Pay Here Dealers (NABD), which will host its 3rd annual Underwriting and Collections Conference in Houston, Texas on November 8-10, 2009. This conference will feature many of the nation’s most successful operators who will discuss their underwriting and collection strategies. Anyone who is seeking more information or wants to register should call 713-290-8171 or visit the NABD web site at www.bhphinfo.com.