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Buying, Selling and Valuing Motorsport and Automotive Dealerships

Volkswagen Dealership Values & Emissions Scandal Update: What Dealership Buyers and Sellers Need to Know

By now most people are aware that Volkswagen came to a crossroads, having to balance performance with emissions requirements, and keeping some of its diesel cars affordable for consumers and profitable for VW.

In 2005 Wolfgang Bernhard, former Daimler Chrysler President and COO, was newly appointed president of the VW brand. Early in his VW tenure he had an idea to fix the emissions problem and comply with the required EPA diesel-engine standards. The problem with Mr. Bernhard's idea was that it would cost approximately 300 euros per car in 2005 euros.

VW engineers were concerned that Mr. Bernhard's solution would decrease the mileage and performance benchmarks that they felt were necessary to make their diesel cars perform (drivability, and performance) like a gasoline car, while offering the consumer much better fuel economy. Volkswagen apparently made a financial decision not to spend the additional 300 euros and instead performed a financial risk assessment. This is par for the course in the business of manufacturing automobiles. When the upside is billions of dollars of additional net profit and the corporate bosses are demanding forever-increasing profits, it's easy to see that the common denominator of greed and pressure to deliver results outweighed a simple decision not to cheat. You might not be aware, but GM, Ford, and Honda have all paid fines for utilizing emissions-defeat devices in prior production vehicles.

In the US, it is a felony for an individual to lie to a federal agent. No such charge clearly exists for corporations that engage in deception regarding their dealings with the Environmental Protection Agency. This created a perceived atmosphere of impunity when it came to VW's decision to intentionally deceive the various worldwide environmental authorities. This was likely considered when the decision was made to install software that would falsify emissions for EPA compliance. I am confident that the US government has considered this over the years and will likely make such intentional deception a crime which will hold corporate officers personally liable. If they do not, I believe we can expect more of the same.

For those not aware, Bernhard told his employees to implement a Urea with catalytic converter system that would comply, but he was told the deterioration to both performance and fuel economy and the additional product costs (300 euros) were prohibitive. The VW diesel vehicles went forward with the defeat software and the rest is history. The numbers are as follows.

Two cars tested by consumer reports with and without the emissions working properly.

Car 1 - 2011 VW TDI

- WITHOUT emissions active: 0 to 60 was 9.9 seconds and mileage was 50 miles per gallon.
- WITH emissions active: 0 to 60 was 10. 6 seconds and mileage was 46 miles per gallon.

Car 2 - 2015 VW TDI

- WITHOUT emissions active: 0 to 60 was 9.1 seconds and mileage was 53 miles per gallon.
- WITH emissions active: 0 to 60 was 9.2 seconds and mileage was 50 miles per gallon.

The differences in these numbers are immaterial. The control system would have had MINIMAL impact on the consumer other than overstating the mileage, and the performance deterioration would be negligible. Quick math shows the additional fuel cost is between $300 and $500 dollars over 100,000 miles of driving.

Some additional math: 500,000 car owners driving cars whose mileage will decrease 5 and 10 percent. If the actual useful life of the fleet were 70 percent, then the fuel decrease would be paid on 350,000 cars at an average of $400. That would be $140 million of actual damages to consumers regarding the fuel mileage. It would then be allocated based on the remaining life of the car. Fairly straight forward. For a company that made 15 billion dollars, probably not an issue. Accepting an owner's complaint about going from 0 to 60 in .2 to .6 seconds longer is dubious at best. A trier of fact like a judge, jury or arbitration board would likely find that consumers would have purchased the car for the same price even with the undetectable difference in performance. The test for that would likely be having 100 Volkswagen TDI owners driving a pool of cars with and without the emissions controls operating and then being asked to determine which car was faster and which was slower. The difference is negligible unless it is the car you have driven for 100K miles, and even then unlikely to be detectable by the typical consumer. Wolfgang Bernhard's testimony at the VW trial should be interesting to see. I don't expect him to take the fifth, but I am sure that he is hoping that a settlement is agreed upon before he would be required to testify.

The valuation question: What is the future going forward for VW dealerships?

I believe where there is adversity there is opportunity. If I were a VW dealer I would be very excited about a couple of opportunities. The first great opportunity is that dealerships are going to be meeting people that have never been in their service departments. They are going to have an opportunity to tell their dealership story, to fix the consumer's car and give the consumer an exceptional experience. Smart dealers are going to be explaining that they too are consumers of VW products. Additionally they will emphasize that decisions made a decade ago are now impacting their employees and their families. Although they took no part in those decisions, they are paying dearly with the attachment of a scarlet letter -- all without being guilty of having done anything wrong.

I recommend that dealers, at the earliest possible date, provide an emissions compliance car at their dealerships for customers to drive to dispel the rumors regarding degraded drivability and performance. Additionally they should have a thorough explanation of the necessary repairs, and be able to reassure their customers of the facts, which will eventually come to light. The facts are the facts; failure to put the equipment on the car was not about mileage or performance, it was a calculated decision by rogue VW employees to save costs by shortcutting a system everyone is required to follow. The people that executed the fraud have been terminated and VW will continue terminating those responsible in a corporate purge the likes of which has never been witnessed before.

Our conversations with our clients have revealed some interesting facts about consumer attitudes and behavior. The number one attitude by the customers is complete apathy. This is slightly more than 50 percent of the customers. They don't seem to really care. They like their car (probably it is not their first diesel), and have little interest in paying attention to the drama. The second set of consumers is worried that the rogue acts of former VW personnel will affect the value of their cars. In the short term, this is probably true until the truth about mileage and performance becomes widely known, with the immediate result being that the cars will be considered damaged goods. In the short term this will create a fairly wary group of buyers. Once VW goes to trial and/or settles, which will likely be sooner than most people are currently thinking, the minimal differences in fuel economy and performance will become understood.

It is apparent from several interviews I have conducted with clients that VW is struggling to understand how to help dealers. Competing brands are conducting an orchestrated feeding frenzy conjoined with local law firms advertising "buy here sue here" incendiary messages on TV and billboards. The message VW is missing is that the competitors' goals are to strip VW of market share long term by offering consumers a solution to getting out of cars consumers feel are tainted merchandise. The tainted merchandise message is the core of the competitions' message. This message is being reinforced at VW dealerships when VW dealers tell consumers that they cannot sell them a new diesel nor take theirs in trade for an amount near the pre emissions scandal news. Currently VW diesel lease returns are being sold at auction for 50% of their previous wholesale/trade-in pricing.

The math is fairly simple.

- Dealership sales are off in all lines and completely dead in VW diesels since sales are on hold.
- A 30% decrease in new cars sales likely turns a profitable store into one that loses money.
- Long term market share is being lost, likely taking many years to regain.
- Store values will be affected negatively long term.
- Volkswagen's damages will extend to dealership values as well as to consumers.
- In a 5x valuation market, each $100,000.00 decrease in store EBITDA translates into $500,000.00 of pre-tax damages to the dealer.
- Key dealership personnel will likely flee the ship short term exacerbating the dealerships' profitability issues.

- To maintain personnel, dealers will likely need to sub vent key personnel pay plans further accelerating losses or lowering profitability.

The interesting part is that VW could avoid or at least greatly decrease consumer damages and dealership damages by simply right-sizing the consumer trade-in issue through subvention. VW is also trying to shore up their network with cash payments to their dealers, but will need to do this monthly, long term until current 2016 models come off hold and in-market models can start being repaired. This would leave the loss of market share as the only issue that cannot be addressed except over time. This will be the true damage to the dealer body and the hardest to calculate in the near term.

Dealership Value Summary

It will be a bumpy ride for a while if you are considering selling. If you are out buying and can find a VW dealer willing to sell at a discount, I think you roll the dice and buy a store. VW is a huge (world's largest), successful automotive company, and once they put this crisis in their rear-view mirror, they will continue as they have done for the last 78 years, developing world-class, well-engineered automobiles. VW is Audi, Porsche, SEAT, Skoda as well as many other premium brands like Bentley, Bugatti, and Lamborghini plus VW Finance. If VW dealers in the US are smart, they will work to distinguish the difference between themselves as dealers and the rogue VW employees. It will take some time to resonate, but in the interim VW has millions of loyal customers in the US, including myself.

VW will undoubtedly come out with some great sales promotions and programs, and it has recently sent its dealers checks in the mid to high five figures and low six figures just because they want to make sure their dealers can look after their customers at VW's expense. That was a class thing to do. It will not be a lot of fun in the short term, but the smart dealers are in the process of turning lemons into lemonades. We all knew that if we made it out of the recession, those dealers that survived would make a lot of money when the market came back. I think we all see that prediction was accurate. The same thing will happen with VW dealerships. Short term, it will not be a lot of fun, long term a lot of consumers are going to be able to get some unbelievable deals on VW products: once-in-a-lifetime good deals, and the dealers who figure this out will be here to reap the rewards. This is a great business!

Mark Johnson is the President of MD Johnson, Inc.
www.mdjohnsoninc.com
mark@mdjohnsoninc.com

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