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Driving the automo-bezzle

Last year marked the sixth consecutive year of rising American light-vehicle sales. Could 2016 make a seventh? If so, never mind the record books. You'd have to turn to the history books. "The last time there were at least seven consecutive years," Jesse Snyder, opinion-page editor of *Automotive News*, tells *Grant's*, "was the streak that started in 1909 when the Model T was introduced."

Now in progress is a skeptical note on the quality of Detroit's arithmetic. In preview, we find it wanting. We suspect that it may likewise prove to be top-making.

Embezzlers are busy in all times and cycles. What ordinarily brings their work to the attention of the police are the circumstances of the down cycle. Undetected embezzlement had no name until John Kenneth Galbraith invented one. He called it the "bezzle."

The author of *The Great Crash* elaborated on his coinage: "In good times people are relaxed, trusting, and money is plentiful. But even though money is plentiful, there are always many people who need more. Under these circumstances the rate of embezzlement grows, the rate of discovery falls off, and the bezzle increases rapidly. In depression all this is reversed. Money is watched with a narrow, suspicious eye. The man who handles it is assumed to be dishonest until he proves himself otherwise. Audits are penetrating and meticulous. Commercial morality is enormously improved. The bezzle shrinks."

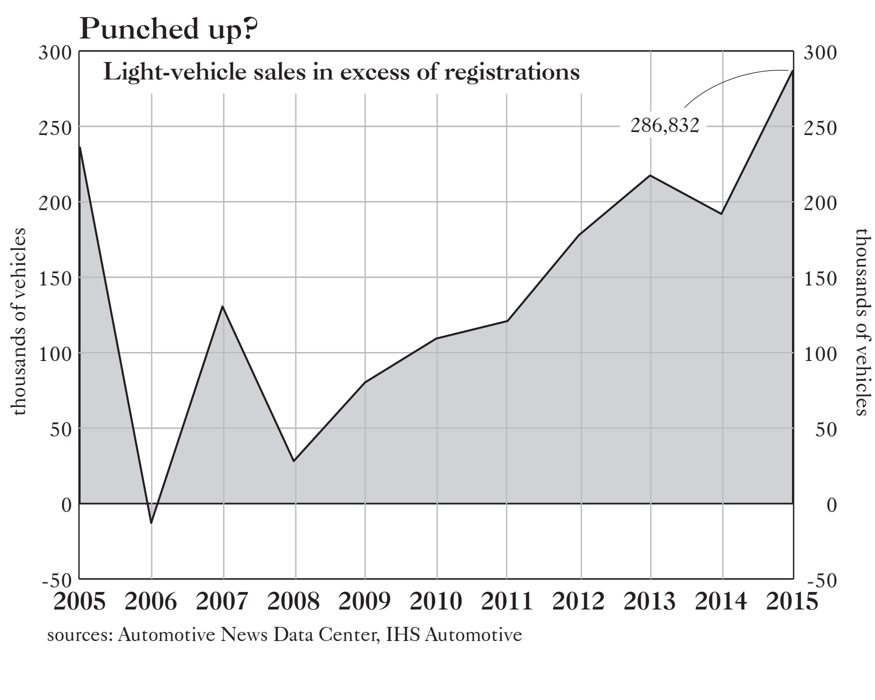
To read Jesse Snyder in the *Automotive News* of March 21 is to suspect that the automo-bezzle is growing. The editor quoted with approval some remarks by the CEO of AutoNation, Mike Jackson, about the industry's growing dependence on incentives and leasing to maintain a volume of sales "that really isn't there."

"I share his concern," Snyder went on, "and I would add long-term auto loans and heavy fleet volume to the mix. But what really alarms me? Reporting as 'sold' new vehicles that stay on the lot as service loaners, rentals, demos or 'executive' cars. Vehicles quickly resold as used at big discounts, with little or no mileage."

If these tricks of the trade were not a little familiar, they would have no name. "Punching" is the adepts' term for them. While there's no telling exactly how prevalent they are, you can get some idea by comparing the disparity between sales and registrations. Between 2005 and 2014, Snyder reported, the difference averaged 128,000 per annum: "But in 2015, that jumped to 286,832. That's a lot of, ahem, service loaners."

We called the editor to draw him out. Snyder graciously came to the phone and lingered awhile. "Somebody moving 1,000 new cars a year, they're going to have some service loaners, and you want them to have late-model cars," Snyder told colleague Alex Hess. "It's just, when is it excessive?"

Is car-punching endemic? Probably not, Snyder replied: "We're still trying to get our arms around it, on the pervasiveness, and we've talked to an awful lot of people in the industry. This is



sources: Automotive News Data Center, IHS Automotive largely anecdotal at this point, rather than systemic. We're working on it, and we may find there is more."

What prompts the cheating? To start with, Snyder answered, there's pressure to hit sales targets. Then there's a "stair-step" incentive structure: "If you sell 80 vehicles, over and above everything else, [the manufacturer will give you] $100 per car that you've sold this month . . . if you make 100, [you earn] $200 per car. If you make 110 or 120, [they] give you $300 for every car you've sold."

Jackson's reference to a sales volume "that really isn't there" set our own editorial antennae to quivering. The 17.5 million new cars and trucks that rolled off dealer lots in 2015—either sold or leased, with a heavy new emphasis on leasing—constitute an all-time calendar-year record. The latest headline numbers might have suggested that 2016 is on course for something even better. Thus, in the three months through March, light-vehicle sales climbed by 3.4%.

The headlines were more hopeful than the text beneath them. In an April 4 memo, Goldman Sachs analysts Patrick Archambault, David Tamberrino, Stefan Burgstaller and Jay Yang called attention to some un-bullish details: "Overall vehicle unit sales . . . fell 4.4% when adjusted for selling days (27 in 2016 vs. 25 in 2015)." They noted, too, that at a seasonally adjusted annualized rate, March sales came in at 16.6 million, vs. a year-to-date, seasonally adjusted run rate of 17.2 million. Should they hold pace, vehicle sales would fall slightly short of last year's fabulous totals.

That the best of the cycle is likely in the rearview mirror is not the hottest new idea of the spring season, admittedly; Mr. Market today assigns price multiples of 4.9 times 2016 earnings for Fiat Chrysler Automobiles, and 5.4 times and 6.5 times the same for General Motors Co. and Ford Motor Co. The Center for Automotive Research is out with a set of downside scenarios in which sales dip by 12% and 33%, respectively, in 2018.

Of course, no amount of punching could produce the sales gust that low gasoline prices and even lower borrowing costs have delivered. Dollar-denominated interest rates on a 48-month car loan have fallen in each of the past eight years, to 4.0% in 2015 from 7.6% in 2007. The Goldman auto analysts point out that low rates and extended maturities largely served to neutralize the 21.8% rise in average selling prices that the automakers pushed through between January 2009 and September 2015. This shift was accompanied by an ever-rising share of new-car buyers who rely on financing, and a drop in consumer credit scores, according to data from Experian for the fourth quarter of 2015.

Not that the evident outbreak of punching is without its own message. "This kind of stuff goes on to some degree when there is more pressure on manufacturers, and on the individual managers within each manufacturer, to do this," says Snyder. "Before things go bad, [the manufacturers tell themselves] 'I want one more big score.' If I'm going use a stock-market analogy: One more summer in the Hamptons before the recession hits."

Once a car has been punched, that "sale" must be replaced next year, lest growth be seen to stop. And therein lies the trouble: What happens when these "sales" cannot be replaced? Does the dealer punch more vehicles, and more, until finally the truth peeps out?

And what happens when they take away the "punch" bowl?

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