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## MIAMI CAR CARE CENTER INC.

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*Julie Harvey prepared this case under the supervision of Elizabeth M.A. Grasby solely to provide material for class discussion. The authors do not intend to illustrate either effective or ineffective handling of a managerial situation. The authors may have disguised certain names and other identifying information to protect confidentiality.*

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On the evening of June 2, 2005, Brad MacDougall, account manager at the London, Ontario, branch of the Business Development Bank of Canada (BDC), began reviewing a loan request from Richard McKinnon, owner and president of Miami Car Care Center Inc. Miami Car Care was a six-bay, self-serve, coin-operated carwash located in south London. McKinnon, a previous client of the BDC, had requested a \$1 million long-term loan to finance the opening of a second London location in the city's north end, scheduled to begin business in January 2006. MacDougall knew that McKinnon was relying on the BDC to finance the expansion.

### COMPANY BACKGROUND

Prior to starting his own company, McKinnon had enjoyed a 23-year career in business management and technology at Accuride Canada Inc., an engineering and design company in London, Ontario. As a long-time "muscle" car enthusiast and aspiring entrepreneur, McKinnon had always wanted to have a family-run business relating to the auto-care industry. Combining his work experience with his keen interest in performance cars, McKinnon established Miami Car Care Center (MCC), a state-of-the-art, six-bay, self-serve carwash, in the spring of 2004. Although the business, located in London's south end, had just finished its first year of operation, MCC had garnered an excellent reputation within the London community as a premium facility, offering a convenient, well-maintained location, exhibiting exceptional service and value. Brad MacDougall had arranged the loan for this location, first establishing MCC's relationship with the BDC. The loan was currently in good standing with all payments up-to-date.<sup>1</sup>

Although McKinnon's full-time job with Accuride was very demanding, he was highly committed to the success of his new business. For example, McKinnon had already contributed personal funds of over \$250,000 to avert the need for additional bank financing. He also intended to reinvest total operating profits back into the company. Operations were managed with discipline and accountability. McKinnon

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<sup>1</sup>A term bank loan was secured by land, building, equipment and McKinnon's personal assets.

set daily, weekly and monthly performance goals, kept a detailed record of all expenditures and attempted to respond personally to all customer complaints or concerns.

McKinnon's wife, Wendy, was the company's controller and handled the business's accounting activities. Kevin McKinnon, the couple's son, was the operations manager in charge of day-to-day operations and equipment maintenance. Their daughter, Terri McKinnon, was the marketing co-ordinator, responsible for signage and marketing programs. The site was cleaned daily by a contracted third party. Sales had continued to increase since opening day, contributing to a track record of consistent growth.

## THE LONDON MARKET

London, Ontario, had a population of approximately 335,000. It was Canada's 10th-largest city and, located halfway between Toronto and Detroit, the city was an excellent location for business and industry. London's economy had witnessed significant growth in the past five years and was predicted to be one of the top performing Canadian metropolitan economies in future years.<sup>2</sup>

The London auto-care market had benefited from the city's economic growth. With an increase in local development and an overall increase in the number of automobiles on the road, London currently supported over 30 carwashes.<sup>3</sup> Operations could be divided into two distinct markets: automatic carwashes or "line" systems (like those seen at major gas stations), and self-service carwashes comparable to MCC.

Although both markets had experienced significant technological advancements over the past two decades, recently, a more notable difference in self-service operations was evident from the customer's perspective. Historically, older self-serve carwashes often suffered from a negative perception because many facilities were poorly maintained, had substandard equipment and looked rundown or unkempt. Businesses now recognized the need for a business model with better customer service, resulting in the phasing out of these obsolete facilities. Six of the 14 self-serve carwashes operating in London were now multi-bay, state-of-the-art, quality-oriented operations that focused on customers and sought to establish a loyal clientele.

One of the newest and most novel operations located north of the city offered a dog-washing facility (which could be a messy job to do at home), so that customers could bathe their pet and wash their vehicle on the same outing. Not only was self-service car washing garnering a broader base of customers, the concept was also becoming a more attractive business venture to entrepreneurs in the London area. Low overhead costs (most facilities could operate without the presence of an attendant), low working capital requirements and the appeal of a cash-based business made self-serve car washes inviting business models.

## THE CONSUMER

With better equipment and more attractive facilities, self-service carwashes were no longer reserved for die-hard car enthusiasts. Modern self-service carwashes now drew a wide range of customers including all age groups, income levels and a proportionate number of men and women.

<sup>2</sup>London Economic Development Corporation, [www.ledc.com](http://www.ledc.com), accessed May 10, 2005.

<sup>3</sup>[www.yellowpages.ca/searchBusiness](http://www.yellowpages.ca/searchBusiness), accessed May 10, 2005.

Consumers chose self-service over automatic carwashes for a number of reasons. Many believed that hand washing provided a more thorough cleaning than automatic machinery. Some believed that the brushes used in automatic washes could damage a vehicle's chrome and paint surfaces over time. Although many automatic carwashes provided a "touchless" wash, preventing brush scratches, many customers preferred the improved quality and safety of washing their own vehicle. The convenience of using self-serve washes (most facilities were open 24 hours a day, seven days a week) was also attractive. As well, unlike automatic carwash customers, self-service carwash customers usually washed their cars as a planned activity and generally chose the facility closest to home, unless that wash was considered inferior to others in the vicinity. There were, however, customers who wanted their car cleaned as quickly as possible with minimal effort and thus chose an automatic carwash. Although there was some overlap, most customers did not wash their cars using both methods. For this reason, McKinnon believed that automatic carwashes were not direct competitors to MCC.

### **MIAMI CAR CARE CENTER**

Miami Car Care Center was the newest facility in the south end of the city and it competed with three older carwashes. MCC was designed and constructed with service, convenience and ease of use in mind. Customers drove front-first into one of six, well-lit, oversized bays and prepared their vehicle for washing (ensuring windows were up, floor mats removed, etc.). The customer then requested the number of wash minutes required and inserted coins, pre-purchased "Miami tokens," or a credit card into a computerized payment machine to activate the cleaning equipment. The customer then used a ceiling-mounted swivel-hose with a soft-bristled brush attached to the end to apply water, a foamy tricolored soap, polymer conditioners, wax and a final spot-free rinse. Once done, towels and other vending products could be purchased for hand-drying and detailing vehicles. Customers could then buy minutes at one of six premium high power car vacuums outfitted with fragrance sprayers and carpet shampooers.

Unlike other facilities, MCC played upbeat music to enhance the customers' experience while they were inside the wash-bays. MCC also offered only the highest quality products and the best technology in all its services. The facility was monitored daily and was configured to ensure that sufficient soap and water pressure were maintained to provide good performance and customer satisfaction. McKinnon thought that MCC set itself apart from other self-serve carwashes with its superior facilities, attention to customers and colorful and stylish design. As Accuride's director in manufacturing information technologies, McKinnon was particularly focused on capacity issues: he wanted to ensure that each bay was occupied as much as possible, while ensuring lineups did not exceed two vehicles at any given time.

McKinnon knew that location was critical to a carwash's success and thoroughly assessed the south London area before committing to building plans. In his research, he had found that, as a general principle, a surrounding population of 1,500 within a given radius would support one self-serve wash bay; consequently, MCC's location was well within this population guideline. The site was a corner lot, providing easy side street access and was located in an area with traffic flow of up to 22,000 vehicles each day. Additionally, over 50,000 vehicles daily used the access ramps to Highway 401, a major provincial highway located a few blocks away. The surrounding community was experiencing major growth and was home to a population of 80,000 people who occupied the neighboring apartment buildings, townhouses and single-family dwellings. Because of its superior facilities, good customer service and prime location, McKinnon was confident that word of mouth and drive-by observation was the best form of advertising for MCC to help build a loyal customer base.

Aside from location and quality of facilities, the major driver for carwash sales was weather conditions. The carwash market was subject to major weekly, monthly and seasonal fluctuations during the year and was especially sensitive to rain, snow and extreme cold weather. Forty per cent of MCC's sales occurred in the spring and summer months, with additional spikes on sunny days and long weekends. Given this seasonal effect, it was imperative that sufficient cash be available when required for supply refills, equipment maintenance and other monthly operating costs. McKinnon estimated that an additional \$15,000 was needed between the months of November and February to finance slower sales.

### **MIAMI CAR CARE CENTER NORTH**

The consistent growth in the number of automobiles on the road and rise in auto-care interest amongst consumers provided an increased opportunity for carwashes. These factors had resulted in a boost in the number of state-of-the-art, self-serve carwashes in London. With the city's growing economy, ongoing development and consumer interest in these carwashes, McKinnon knew it was important to further establish MCC in key London locations before the competition did.

Excited about MCC's success, McKinnon was eager to capitalize on the company's momentum. He wanted to increase MCC's market share and believed the opening of an additional London location was critical to achieving this goal. Another reason for the expansion was to take advantage of the economies of scale associated with operating a second facility. McKinnon believed that revenues generated from the new carwash would translate into significant increases in company profits because the infrastructure necessary to support higher sales volumes was already in place, thus limiting proportionate increases in overhead expenses.<sup>4</sup>

The new MCC facility would be located in the north end of the city in an even more densely populated area than the first location, with 150,000 residents, drive-by traffic of over 50,000 automobiles each day and a nearby shopping plaza consisting of major big-box retailers and fast-food chains. There were also three older carwashes in the area.

McKinnon was particularly excited because the new site could support an even larger operation with more amenities than the original location. This improved design included eight oversized wash bays and an onsite automatic carwash in addition to the self-serve bays. McKinnon planned to use the same leading technology for equipment and operations and of course, the same customer-focused approach that had contributed to the success of the first location. In fact, MCC North was anticipated to be the premier carwash and auto care facility in all of London.

### **Financial Projections for the Expansion**

McKinnon knew that MCC North would require a combination of long-term debt and equity to fund the land, building and equipment purchases. As a condition of the \$1 million long-term loan request from the BDC, McKinnon would have to contribute \$450,000 in equity to help fund the \$1.45 million investment.<sup>5</sup> McKinnon was confident that he could meet this condition of the loan agreement. If the loan request was approved, the business would need to make payments of \$60,000 annually on the new BDC loan. Although McKinnon had not requested an increase on the business's \$30,000 line of credit, MacDougall

<sup>4</sup>Infrastructure being data management software, various service and utility contracts, etc.

<sup>5</sup>Including land at \$315,000, depreciable assets amortized over 18 years.

wondered whether the current limit would be sufficient to support the business's working capital needs for the expansion.

In estimating sales for the coming years, McKinnon expected steady growth at both locations. He anticipated the existing facility's sales to increase 35 per cent over 2005 levels in 2006 and another 30 per cent over 2006 levels in 2007. The new facility's sales were projected to total \$340,000 in 2006 and \$400,000 in 2007.

McKinnon expected cost of goods sold to increase closer to industry standards, to 30 per cent of sales, given the anticipated increases in utility and other direct sales costs. A new manager would be hired at an annual salary of \$40,000 and additional administration costs for both operations were budgeted at \$1,600 each month. McKinnon also expected Miami Car Care's insurance expense and property tax to at least double and projected a total of \$40,000 in annual interest charges on the new loan. Most other operating expenses would remain roughly the same percentage of gross sales as was experienced in 2005. Although McKinnon did not plan to take dividends within the next five years, he hoped to eliminate the due-to-shareholders account by 2007, assuming the business could generate sufficient funds to afford the reduction.

## **THE DECISION**

As he thought back to their first meeting, MacDougall recalled the dedication and passion McKinnon exhibited for his business. Despite MCC's strong financial performance and McKinnon's disciplined management style, MacDougall was concerned about the relatively short time MCC had been in business. MacDougall would have preferred at least three years of financial data to track performance. With only the past four fiscal quarters to make a decision (see Exhibits 1 to 5), he questioned whether MCC could even afford the expansion if the operating line of credit were not also increased.

It was important that MacDougall make a well-thought-out decision. He knew McKinnon was counting on the BDC to provide the major long-term financing for the new facility and to be up and running by January 2006.

## Exhibit 1

STATEMENTS OF EARNINGS (UNAUDITED)  
(for three-month periods)

	Total June 1 2004 to May 31 2005	Mar 1 2005 to May 31 2005	Dec 1 2004 to Feb 28 2005	Sept 1 2004 to Nov 30 2004	June 1 2004 to Aug 31 2004
Gross sales					
Car washes/vacuums	\$ 143,988	\$ 61,082	\$ 44,477	\$38,429	\$ -
Vending products	<u>5,677</u>	<u>2,378</u>	<u>1,373</u>	<u>1,926</u>	<u>-</u>
Total gross sales	\$ 149,665	\$ 63,460	\$ 45,850	\$40,355	\$ -
Cost of goods sold <sup>1</sup>	<u>39,770</u>	<u>14,130</u>	<u>16,709</u>	<u>8,931</u>	<u>-</u>
Gross profit	\$ 109,895	\$ 49,330	\$ 29,141	\$31,424	\$ -
Operating expenses					
Advertising and promotion	4,519	1,121	544	2,395	459
Amortization expense <sup>2</sup>	40,577	10,755	10,490	10,438	8,894
Computer expense	512	240	258	14	-
General and administration	8,542	4,001	2,191	2,683	(332)
Insurance	5,564	1,013	1,013	2,018	1,521
Legal and accounting	1,413	47	50	319	996
Travel and entertainment	777	451	27	223	76
Miscellaneous	661	325	258	78	-
Office expenses	517	247	-	270	-
Property tax	1,701	424	423	427	427
Telephone	1,600	337	423	613	227
Salary and wages	<u>7,708</u>	<u>3,536</u>	<u>2,716</u>	<u>1,456</u>	<u>-</u>
Total operating expenses	\$ 74,091	\$ 22,497	\$ 18,393	\$20,934	\$ 12,267
Operating income	\$ 35,804	\$ 26,833	\$ 10,748	\$10,490	\$ (12,267)
Other income (loss)	632	(199)	46	57	727
Interest expense	<u>39,924</u>	<u>12,065</u>	<u>12,806</u>	<u>11,565</u>	<u>3,488</u>
Income (loss) before taxes	\$ (3,488)	\$ 14,569	\$ (2,012)	\$(1,018)	\$ (15,028)
Income taxes	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
Net income (loss)	\$ (3,488)	\$ 14,569	\$ (2,012)	\$(1,018)	\$ (15,028)

Source: Company files.

<sup>1</sup>Cost of goods sold (COGS) includes water, electricity, gas, carwash and vending supplies and sewer disposal expenses.<sup>2</sup>Includes amortization on depreciable assets and organization expense.

## Exhibit 2

**STATEMENT OF RETAINED EARNINGS (UNAUDITED)**  
**(for three-month periods)**

	<b>Mar 1 2005 to May 31 2005</b>	<b>Dec 1 2004 to Feb 28 2005</b>	<b>Sept 1 2004 to Nov 30 2004</b>	<b>June 1 2004 to Aug 31 2004</b>
Beginning retained earnings	\$ (18,057)	\$ (16,045)	\$ (15,028)	\$ —
Add: net income	14,569	(2,012)	(1,018)	(15,028)
Less: dividends	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>
Ending retained earnings	\$ <u>(3,488)</u>	\$ <u>(18,057)</u>	\$ <u>(16,045)</u>	\$ <u>(15,028)</u>

**Exhibit 3**  
**BALANCE SHEET (UNAUDITED)**

	As at May 31 2005	As at Feb 28 2005	As at Nov 30 2004	As at Aug 31 2004
<b>ASSETS</b>				
Current assets:				
Cash	\$ 22,852	\$ 2,696	\$ 9,726	\$ 18,749
Inventory	1,010	247	146	-
Prepaid expenses	995	995	995	-
Other current assets	<u>-</u>	<u>-</u>	<u>29,667</u>	<u>16,837</u>
Total current assets	\$ 24,857	\$ 3,938	\$ 40,534	\$ 35,586
Fixed assets:				
Land	176,161	176,161	176,161	176,161
Building	454,203	444,433	441,942	351,328
Signage	16,629	16,629	16,629	16,629
Carwash equipment and machinery	212,775	206,269	205,621	197,391
Office furniture and fixtures	1,120	428	428	428
Computer equipment	<u>2,476</u>	<u>2,476</u>	<u>2,262</u>	<u>2,262</u>
Total (cost)	\$ 687,203	\$ 670,235	\$ 666,881	\$ 568,037
Less: accumulated amortization <sup>1</sup>	<u>40,505</u>	<u>29,768</u>	<u>19,296</u>	<u>8,876</u>
Net fixed assets	\$ <u>646,698</u>	\$ <u>640,467</u>	\$ <u>647,586</u>	\$ <u>559,162</u>
Total fixed assets	\$ 822,859	\$ 816,628	\$ 823,747	\$ 735,323
Other assets:				
Organization and development, net	960	978	996	1,014
Investments	<u>29,804</u>	<u>19,295</u>	<u>8,857</u>	<u>(18)</u>
<b>TOTAL ASSETS</b>	<b>\$ <u>878,480</u></b>	<b>\$ <u>840,840</u></b>	<b>\$ <u>874,134</u></b>	<b>\$ <u>771,905</u></b>
<b>LIABILITIES</b>				
Current liabilities:				
Line of credit (\$30,000 limit)	\$ 29,767	\$ -	\$ 13,300	\$ 300
Accounts payable	7,746	7,654	12,540	24,596
Taxes and GST account	1,037	1,315	567	(22,070)
Current portion of long-term debt	<u>7,553</u>	<u>7,634</u>	<u>7,695</u>	<u>6,761</u>
Total current liabilities	\$ 46,103	\$ 16,603	\$ 34,102	\$ 9,587
Long-term liabilities:				
Term bank loan	596,662	603,091	607,875	534,143
Due to shareholders	<u>239,003</u>	<u>239,003</u>	<u>248,003</u>	<u>243,003</u>
Total long-term liabilities	\$ 835,665	\$ 842,094	\$ 855,878	\$ 777,146
Shareholders' equity:				
Common stock	200	200	200	200
Retained earnings	<u>(3,488)</u>	<u>(18,057)</u>	<u>(16,045)</u>	<u>(15,028)</u>
Total shareholders' equity	\$ <u>(3,288)</u>	\$ <u>(17,857)</u>	\$ <u>(15,845)</u>	\$ <u>(14,828)</u>
<b>TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY</b>	<b>\$ <u>878,480</u></b>	<b>\$ <u>840,840</u></b>	<b>\$ <u>874,134</u></b>	<b>\$ <u>771,905</u></b>

Source: Company files.

<sup>1</sup>Calculated on all fixed assets except land.

**Exhibit 4**  
**FINANCIAL RATIOS AND SELECTED INDUSTRY RATIOS**

	Total Ending May 31, 2005	Mar 1 2005 to May 31 2005	Dec 1 2004 to Feb 28 2005	Sept 1 2004 to Nov 30 2004	June 1 2004 to Aug 31 2004	North American Self-Service Car Wash Industry Results 2004 <sup>1</sup>
<b>PROFITABILITY</b>						
Gross sales						
Car washes/vacuums	<b>96.2%</b>	96.3%	97.0%	95.2%		92%
Vending products	<u>3.8%</u>	<u>3.7%</u>	<u>3.0%</u>	<u>4.8%</u>		<u>8%</u>
Total gross sales	<b>100.0%</b>	100.0%	100.0%	100.0%	N/A	100%
Cost of goods sold	<u>26.6%</u>	<u>22.3%</u>	<u>36.4%</u>	<u>22.1%</u>		<u>38%</u>
Gross profit	<b>73.4%</b>	77.7%	63.6%	77.9%		62%
Operating expenses						
Advertising & promotion	<b>3.0%</b>	1.8%	1.2%	5.9%		2%
Amortization expense	<b>27.1%</b>	16.9%	22.9%	25.9%		16%
Computer expense	<b>0.3%</b>	0.4%	0.6%	-		
General & administration	<b>5.7%</b>	6.3%	4.8%	6.6%		
Insurance	<b>3.7%</b>	1.6%	2.2%	5.0%		2%
Legal & accounting	<b>0.9%</b>	0.1%	0.1%	0.8%		1%
Travel & entertainment	<b>0.5%</b>	0.7%	0.1%	0.6%		
Miscellaneous	<b>0.4%</b>	0.5%	0.6%	0.2%		21%
Office expenses	<b>0.3%</b>	0.4%	-	0.7%		1%
Property tax	<b>1.1%</b>	0.7%	0.9%	1.1%		3%
Telephone	<b>1.1%</b>	0.5%	0.9%	1.5%		
Salary & wages	<u>5.2%</u>	<u>5.6%</u>	<u>5.9%</u>	<u>3.6%</u>		<u>16%</u>
Total operating expenses	<u>49.5%</u>	<u>35.5%</u>	<u>40.1%</u>	<u>51.9%</u>		<u>26%</u>
Operating income	<b>23.9%</b>	42.3%	23.4%	26.0%		36%
Other income (loss)	<b>0.4%</b>	-	0.1%	0.1%		
Interest expense	<u>26.7%</u>	<u>19.0%</u>	<u>27.9%</u>	<u>28.7%</u>		14%
Income (loss) before taxes	<b>-2.3%</b>	23.0%	-4.4%	-2.5%		
Income taxes	-	-	-	-		N/A
Net income (loss)	<u>-2.3%</u>	<u>23.0%</u>	<u>-4.4%</u>	<u>-2.5%</u>		N/A
<b>LIQUIDITY</b>						
Current ratio		0.54	0.24	1.19	3.71	
Acid test		0.50	0.16	0.29	1.96	
Working capital		\$(21,246)	\$(12,664)	\$ 6,432	\$25,998	
<b>EFFICIENCY</b> (90-day quarters, 365-day year)						
Age of inventory	9 days	6 days	1 day	1 day	N/A	
Age of payables <sup>2</sup>	69 days	47 days	41 days	124 days	N/A	
<b>STABILITY</b>						
Interest coverage	0.91x	2.2x	0.84x	0.91x	N/A	
<b>GROWTH</b>						
Sales		38%	14%	N/A		
Net income after taxes		N/A	N/A	N/A		
Total assets		4%	(4%)	14%		
Equity		N/A	N/A	N/A		

<sup>1</sup>Cost of Doing Business Report, International Carwash Association, March 31, 2004.

<sup>2</sup>Age of payables based on 365 days of purchases.

## Exhibit 5

**STATEMENT OF CASH FLOWS (UNAUDITED)**  
**(for the year ending May 31, 2005)**

**OPERATIONS:**

Net income	\$	(3,488)
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Adjustments to cash basis:

Amortization		40,577
Inventory		(1,010)
Prepaid expenses		(995)
Other current assets		—
Accounts payable		7,746
Taxes and GST account		<u>1,037</u>

Net cash flow from operations		43,867
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**FINANCING ACTIVITIES:**

Line of credit	\$	29,767
Current portion of long-term debt		7,553
Term bank loan		596,662
Due to shareholders		239,003
Common stock		<u>200</u>

Net cash flow from financing activities		873,185
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**INVESTING ACTIVITIES:**

Fixed assets	\$	(863,436)
Organization and development		(960)
Investments		<u>(29,804)</u>

Net cash flow from investing activities		(894,200)
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Net cash flow		22,852
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Beginning cash		<u>—</u>
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Ending cash		<u>\$ 22,852</u>
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Source: Company files.