POWER STEERING

Steering your dealership to higher profits

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National new vehicle sales, cars and light duty trucks, for 2019 were down slightly from 2018. National new vehicle sales have been in the range from 2015 through 2019 from a low of 17.1 million in 2019 to a high of 17.6 million in 2016. This is a very narrow range of national new unit sales. Manufacturers market share that were less in 2019 than 2018 include: Ford, Toyota, Chevrolet, Nissan, Jeep, Dodge, and Mazda.

The enclosed profit survey for December 2019 reflects mixed results. Overall, the “real” consistent profits were down in December as compared to November. However, when looking at the enclosed profit results, they can be misleading. Why? Dealers make their LIFO entries, which can be both a LIFO deduction and LIFO income amounts, year-end bonuses, year-end write-downs and cleaning up accounting reserves which often create distorted income for December, and catch-up of certain expenses, etc.

The enclosed survey also reflects Other Income. This Other Income on average is 12% of total gross and other income and the median is 11%.

Dealership Agreements

We are advised about agreements dealers enter into with vendors. Sometimes we find dealers sign a long-term agreement where if they want to cancel it there is a huge cancellation fee. Also, we see dealers signing long term agreements with I.T. and other vendors where if the dealer wants to sell the dealership, they have to absorb these future payments out of the sales proceeds. We tell dealers they have no reason to sign agreements, excluding I.T. agreements, longer than 12 months. If the vendor pushes a longer than 12 month agreement, then find another vendor. In the alternative, if the vendor including I.T. vendors want a longer agreement, insert in the legal language that if the store is sold, you know what the financial obligation will be canceling the agreement early. Many vendors will quantify this. If they will not, find another vendor. Also, never trust the vendor when they say, “we will treat you reasonably and trust us.” Never believe them or trust them for what they say.

Salespeople

The comment we hear most often from new vehicle dealers is that they are trying to keep their sales force at a reasonable and adequate level. This has always been a concern for dealers for many years. When we observe a low profit or loss dealer, our first question is how many salespeople do they have and how many retail new and used units are they selling? Dealerships should have enough salespeople so that if they each average 9-10 retail units per month the store will have enough salespeople to meet their estimated sales volume. Also, some dealers trying to hire more salespeople are giving these employees titles other than salespeople and in some cases paying higher initial compensation such as $15 per hour for a limited number of weeks.

“The best way to predict your future is to create it.”
— Peter Drucker

Inside

Minimum Wage and Overtime Exemption	2
Dealership Buy-Sells	2
Internal Revenue Service (IRS) Information Returns	2
Monthly Sales and Profit Survey	3
Internal Revenue Service (IRS) Metrics	4

Minimum Wage and Overtime Exemption

At the start of 2020 several new rules have been put in place with respect to minimum wage and overtime exempt employees. With the several large employee pay lawsuits that have popped up throughout the country, it is important for someone at the dealership to be very familiar with the intricacies in payroll laws. This is a very broad and general outline, and as such each dealer should refer to their own state laws, NADA and their state dealers association.

Managers (which includes: sales, parts and service) who earned a $455 salary or draw each week were exempt from overtime pay (over 40 hours a week). This is known as the “white collar” exemption. These managers now must make a $684 salary or draw each week to be exempt from overtime. For safety, employers should not include commissions in this calculation. Managers making less than this amount are eligible for overtime if they work over 40 hours in one week. Salespeople need to at least make minimum wage in each pay period. We are recommending to dealers to increase the draw of these employees and reduce their month end commission. Please note, if the draw is not covered by commission in a pay period the dealer can only charge the employee back in the next payroll period to the extent that minimum wages paid on the last paycheck exceeded the required minimum wage.

Dealers should require a signed, submitted timesheet on a weekly basis. In any dispute with the Department of Labor or employee litigation, these timesheets would be important to support your case that the employee was paid appropriately. The Department of Labor does seem to take the position of supporting the employee in any complaints and it is the employer’s responsibility to prove the pay was done correctly. In reviewing employees pay with these new rules, it would be a great time to inspect that all employees have signed pay plans.

Dealership Buy-Sells

Many potential buyers of new vehicle dealerships usually will value how much to pay for blue sky/goodwill based mainly on “expected” future profits, though they give great “weight” to historical profits. The main concern of knowledgeable buyers is what return on investment do they require on funds they put at risk in buying a dealership. If the selling dealer has low profits or has been losing, the first question we ask, is the “rent,” or facility value reasonable for the size of dealership being purchased? We always ask this because reasonable management should be able to obtain a reasonable level of pre-tax profits, somewhere in the 2.5% pre-tax net profit as a percentage of sales. The National Automobile Dealers Association (NADA) reports that rent and equivalent, mainly rent, property taxes, and facility maintenance approximates 13% of sales or 11% of gross. Based on this average, if the dealership you are purchasing, expected rent and equivalent, is much more than these facility metrics, then you should point out this to the seller and the blue/goodwill should be less than it would be with “normal” rent and equivalent. Therefore, the blue sky should be less than it would otherwise be.

As it relates to return on investment, we always look at it as pre-tax return on investment. When reading articles often it is not clear whether the return on investment is pre-tax or post tax. This makes a huge difference. What we currently see is this pre-tax return on investment ranges from as low as 15% to 25% and more. Prospective buyers should be looking to buy smaller dealerships and those dealerships located in rural areas that can produce returns at the higher end of this range.

Internal Revenue Service (IRS) Information Returns

These IRS returns include, but are not limited to 1099, 8300, 8886, etc. Most dealerships already properly file Form 1099 which is mainly a report of payments made to non-corporations exceeding $600 for the year. IRS Form 8300 is the form where you have received more than $10,000 in “cash” from a customer. If you neglect to file these forms, the penalty can be as high as $25,000 per missed form. IRS Form 8886, a “nuisance” form, is required for certain re-insurance type company entities. This form reports to the IRS certain information including, but not limited to, the re-insurance company name and tax number, dealership selling the product name and tax number, stockholders of the dealership and stockholders of the re-insurance company tax number. The IRS started requiring this “unnecessary” form in the past few years because they thought many taxpayers were abusing and avoiding income taxes. Current IRS employees not knowing about this many years ago are now wasting tens of thousands of hours on businesses having these forms prepared by dealerships and CPA firms. We have never seen or heard a situation that warrants this form.

Internal Revenue Service (IRS) Metrics

The IRS publishes metrics every year from a summary of the personal income tax returns of individuals. The most recent metrics we have are for the tax year 2017 as follows:

Top 1.2% of taxpayers had 11% of adjusted gross income and paid 20% of income taxes, and the top 5% of taxpayers had 37% of adjusted gross income and paid 60% of income taxes. The top 5% starts with adjusted gross income of $200,000. This top 5% is paying 60% of income taxes. Interesting.