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HEADLIGHTS

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Valuation of Goodwill - A Buyer's Perspective

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I often get questions regarding the reasonableness of the goodwill component of a potential acquisition. The prospective buyer typically asks me "what multiple is the franchise selling at?" While I believe that a multiple approach is a quick and easy starting point, it provides only a simple goodwill value range with limited confidence as numerous considerations must be applied to that approach to get a reasonable value. It is my belief that the expected rate of return on investment approach is the approach that provides the most accurate and realistic value of the goodwill component of the acquisition. This approach takes into consideration the expected return on sales based on the operations of the dealership within the buyer's operational model and the total investment required, which includes the expected acquisition costs of furniture, fixtures and equipment and the expected working capital requirement. An example calculation of the goodwill under this approach is as follows:

A. Expected Annual Sales of the Dealership, after Acquisition		$200,000,000
B. Expected Income (Rate of Return on Sales, as a percent)		2.5%
C. Expected Income (Rate of Return on Sales, as a value)	A x B	$5,000,000
D. Expected Rate of Return on Investment		20.00%
E. Total Expected Investment	C / D	$25,000,000
F. Total Expected Cost of Furniture, Fixtures and Equipment		$1,000,000
G. Total Expected Working Capital Requirement		$3,000,000
H. Total Expected Maximum Goodwill	E – F & G	$21,000,000

When evaluating the expected rate of return on sales, it is important to be aware of any unusual non-income related taxes associated with the acquired dealership. As an example, acquisition in an area may have an annual specially allocated state or city tax (i.e. homeless tax) that is based on gross receipts. If this tax is 1% of gross receipts, regardless of income, the expected income (rate of return on sales, as a percent) may need an obvious adjustment.

The expected rate of return on investment approach, appropriately, places little value on the performance of the seller, based on its operational philosophy and model. The performance of the seller can be used as a base guide, but there are many variables that need to be evaluated and adjusted for when doing this. When evaluating a seller's financial performance via dealer statements, I routinely find massive unrecorded expenses buried in the balance sheet, typically recorded in prepaid expenses. A buyer is going to operate the dealership with its philosophy and design, and the expected annual sales and income is going to be predicated on this design. Accordingly, once a reasonable annual sales expectation is ascertained by a buyer, application of these sales into the buyer's expense design will provide the important income component of the calculation above.

While the above calculation is fairly short and sweet, some of its components require sincere consideration by the buyer, specifically related to the reasonable expectation of sales and income based on the buyer's operation design.

Contact your **AutoCPAGroup** member if you need acquisition assistance. ¶

End of Year Tax Considerations and Other Compliance Issues for Dealerships

Scott Woodward,
Woodward & Associates, Inc.

We are quickly approaching the end of the year, and for many, now is the time to find last-minute ways to decrease the dealership's taxable profit and, in turn, reduce its (or its owner's) tax burden. Dealers are finding their store's profitability is significantly down from prior years. However, every dollar that can be reduced in taxes can help the individual or business's financial health.

Accounts Receivable

Go through all the dealership's various receivable accounts (contracts in transit, customer receivables, factory receivables, finance reserves, etc.) and look for uncollectible balances. If the dealership feels there is no ability to collect it, write it off to bad debt expense.

Inventory

If you are not on new vehicle LIFO, consult with your tax preparer. LIFO is a great way to reduce current year tax liabilities. LIFO can leave cash in the store to pay down other debt, or simply help reduce your tax liability.

Inspect your used vehicle inventory. The IRS allows dealerships to write down used vehicles to average wholesale. There are possible steps your CPA might be required to take, so please consult with them before doing so. Instead of writing down each specific unit, we suggest putting the write-down into its own balance sheet account or control number at the bottom of the inventory schedule, and do not use this reserve when selling the vehicle. This prevents accidentally paying salespeople on "fake" gross profit.

Review your parts aging. Have your parts manager dispose of any old, unsaleable parts and simultaneously compare your parts pad to your dealer statement or accounting inventory to see if an adjustment is needed on the accounting inventory. You should do the same for gas, oil, grease, tires, etc. Dealerships routinely do not compare the parts pad to the accounting inventory, and when it's done, they find that a material adjustment is needed.

Other Suggestions

Do you have any repairs or maintenance that you have put off? Now might be the time to do some of those items to get the expense into 2024. Similarly, you can take advantage of accelerated depreciation on any pre-year-end fixed asset purchases, such as for equipment or furniture, whether paid in 2024 or financed.

Are you planning any end-of-year bonuses to owners or their related family members? If so, be sure to get those paid and included on a 2024 payroll check to be able to expense those items. Typically, owners (and family members of owners) must have their compensation paid for it to be deductible for income tax purposes.

Have any of the owners loaned money to the business? Be sure to pay them interest before the end of the year to receive the tax deduction. They can always reinvest the interest back into the store.

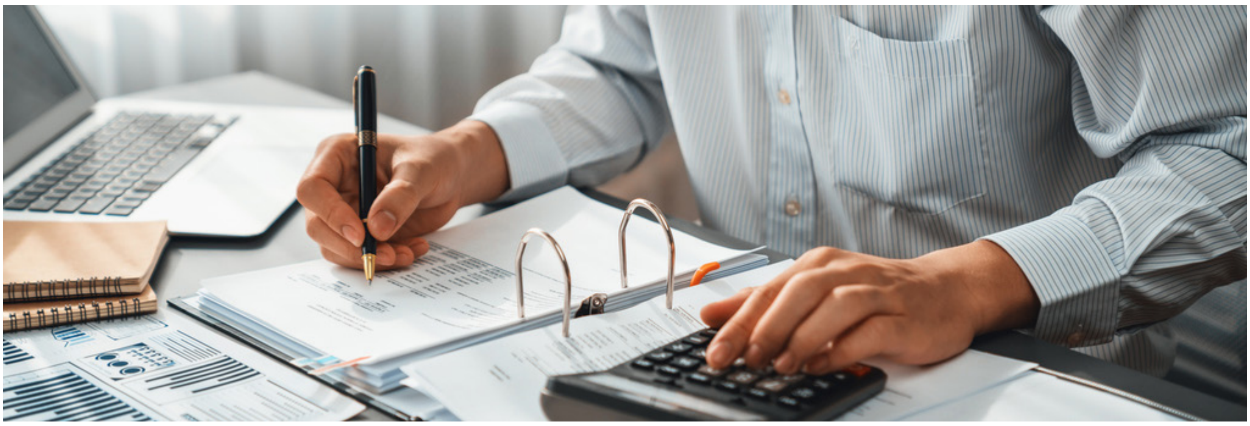
Other Compliance Issues

Have you, or your professionals, filed the new Beneficial Ownership Information (BOI) report for required businesses? The fines can be $500 a day.

Are you submitting the form 8300 electronically? Check with your accounting office or finance department, as effective January 1, 2024, they are required to be submitted electronically.

Are you set up to submit W-2s and 1099s electronically? Many missed these requirements for 2023. The penalties and interest for failure to do so can be significant.

Contact your **AutoCPAGroup** member and take advantage of this opportune time to discuss and implement year-end tax saving strategies. ¶



Review of the Auto Dealer Industry by Metrics - Return of the Old Normal

Scott Womack, LBMC

As we enter the final quarter of 2024, it seems we have returned to the old normal in the auto industry. Over the last three years of heightened dealership profitability, we wondered whether OEMs would choose to operate lean into the future, just as they were forced to during the fallout of the pandemic and microchip crises and the recovery that followed. After reviewing several key automotive statistics this week, it seems as though the OEMs are reverting to their old ways in an attempt to shift profits back more to their share.

In this article, I will review and discuss several key metrics: new vehicle profitability, the supply of new vehicles, average trade-in equity of used vehicles and vehicle miles traveled.

New Vehicle Profitability

Total retail profit per unit realized by auto dealers has continued to decline and normalize since an industry peak of $5,258 per unit in December 2021. The current October 2024 figure of $2,245 per unit has almost normalized to pre-Covid levels of $2,053 per unit.

For context, JD Power reports that only 12.71% of vehicles are selling over MSRP, compared to 27.1% of new vehicles sold in October 2023.

Supply of New Vehicles

During the pandemic and periods of recovery, evidence of a tight supply of new vehicles could be seen in the lack of inventory on auto dealers' lots around the country. The monthly forecasts by JD Power reports the average days for new vehicles to sit on a dealer's lot at 50. This figure is up considerably from a low of 17 in December 2021. Pre-Covid levels hovered around 72 days, and certain OEMs are approaching these figures today.

JD Power reports that 29.7% of new vehicles will sell within 10 days of arriving at the dealership, down from a peak of 58% of new vehicles selling within 10 days in March 2022.

Average Trade-In Equity Used Vehicles

Like new vehicles, used vehicle transaction prices have continued to cool and decline in 2024. Since fewer new vehicle units have been available to sell over the last few years, fewer used vehicles have been traded into the dealer for reselling. As a result, increased demand for used vehicles led the average trade-in equity value for used cars to climb during that same period. Like the other metrics already discussed, average trade-in equity continues to normalize. JD Power reports this figure at $7,909 for October 2024, compared to the high of $10,199 reported in December 2021.

With interest rates beginning to decline, consumers tend to focus more on their monthly payments. If rates and transaction prices both continue to decline, we may see consumers buy new and used vehicles rather than choosing to hold their current vehicles longer.

Vehicle Miles Traveled

Another key indicator that portrays the health of the automotive industry is the number of miles driven or vehicle miles traveled ("VMT").

As with the number of vehicles in service, the number of miles driven contributes to the fixed operations of an auto dealer, as vehicles will require more parts and service when they are driven more frequently or for longer distances.

VMT has been tracked since 1971. The current rolling-12 month total of 3.280 trillion miles is as close to the pre-covid level of 3.285 trillion miles as we have seen, signaling almost a full recovery since people were shuttered at home and off the roads during the early months of the pandemic.

Contact your **AutoCPAGroup** member to discuss current metrics and trends in the auto industry. ¶