

# On Track

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The Driving Force Auto Dealer Consulting Group Newsletter, **On Track**, is published for auto dealerships and related businesses.

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## The Old Rules Don't Apply!

*A few simple rules that will help dealers avoid costly mistakes when dealing with their DMS Computer Vendors*  
by Paul Gillrie

It's been quite the ride lately for dealers in the market to change vendors or upgrade their current systems. If you haven't been following the market, you need to know that things have changed drastically and the old rules just don't apply any longer. Vendors are under tremendous pressure to provide their investors and stockholders a larger return on their investment. As a consequence, we've seen the largest market reorganization in thirty years! Unless dealers move to protect themselves, higher technology costs are very likely.

Even if a dealer can wade through confusion and figure out what he needs to buy, extended contracts, more restrictive terms and mandatory upgrades make it harder for a dealer to keep his options open and strike a deal that makes the most sense for the store. It's harder than ever for a dealer to find the right technology at the right price and have it delivered under an acceptable, fair contract. Confusion is rampant and even the industry news reports seem contradictory. Depend on what your vendor rep tells you and you'll probably find out that not even s/he knows what really happening! Or maybe s/he's not telling you all the truth?

Retaining a dealer's business long term in the face of increased competition, new players and industry reorganization has become a staggering task for vendors. As a dealer, you simply can't depend on what's worked for you in the past. We've seen staggered leases for hardware and agreements for software parlayed into ten and, even twenty year commitments for dealers who, in some cases, don't know how it happened.

Industry guru, Paul Gillrie (*of The Paul Gillrie Institute*) recommends a few simple rules that every dealer should follow:

1. Do not authorize any of your employees to sign any agreement that may obligate your dealership in any way. Immediately inform your employees of this policy and follow up with your computer vendor via certified mail giving them the name(s) of anyone in your organization authorized by you to sign agreements. In most stores, only the dealer should be on that list.
2. Make sure you have every agreement scrutinized by someone familiar with the current industry standards and practices. These agreements sometimes appear to say one thing when the actual intent is very different. Get help - don't get surprised!
3. Make sure all computer contracts are co-terminus contracts. That is that they all terminate on the same date.
4. Begin contract negotiations for upgrades 18 to 24 months before the end of the current contract. Vendors love to run out the clock and thus gain the upper hand because a dealer fears that his system may be shut off. Month-to-month contracts are no panacea. There are serious downsides, both in cost and leverage, with these seemingly innocuous situations.
5. Main stream computer vendors have openly declared war on the third party providers. Third party vendors are tech companies that offer products that compete directly with similar products offered by DMS vendors. A few examples are companies that provide websites, networking, CRM and archiving. By restricting access to your data under the guise of security, vendors now seek to tell dealers which companies they can employ. Would it surprise you to know that this tactic steers you to companies that have a fiscal relationship with the DMS vendor. Remember, if a third party supplier pays a fee to your DMS, that charge will be one you will pay one way or another. Remember, it is not who owns the data. It is who controls the data.

*The Gillrie Institute has agreed to discuss these issues with our clients at no charge and provide them with further guidance and information on implementing the correct defensive practices. Just give them a call at 800-576-6959 and mention this newsletter.*

# If It's Broke . . . Here's How to Fix It.

*An Income and Estate Tax Free Wealth Transfer Strategy for Qualified Plan Assets.*

*By Anthony Freeman*

Successful business owners have always used qualified retirement plans to shelter their taxable income. However, as the law relating to these plans eliminated many of their advantages, most plans were terminated and the account balances rolled over into tax deferred IRA's. These IRA Rollovers continue to grow and many are worth millions of dollars.

Since most of these IRA owners continue to work after reaching retirement age, they do not need or want to take taxable distributions out of their IRA's. Their intention is to pass the money on as their legacy to the next generation.



Unfortunately, the law requires all qualified plan participants that have reached age 70 1/2, to begin taking IRS determined amounts out of their IRA's each year. These withdrawals, called Required Minimum Distributions (RMD), increase in amount as the recipient grows older and are taxed at ordinary income rates.

Finally, at the death of the owner of the IRA Rollover, all funds remaining in his account are subject to both Income and Federal Estate Taxes. These taxes can reduce the legacy passed onto the next generation by as much as 70%.

The reaction of the owners of large IRA Rollover accounts has been predictable. They are furious at being forced to withdraw assets during their lifetime, angered by the resulting reduction in plan assets meant to be passed on to their heirs and outraged by the further reduction of the IRA Rollover assets from Income and Federal Estate Taxes at their deaths.

Successful business owners can achieve their primary goal, to pass a legacy onto the next generation, by taking advantage of an Enhanced Benefit IRA<sup>®</sup> (EBIRA). This plan guarantees the payment of a specified amount to the IRA owner each year for the rest of his life. It also guarantees the payment of the intended legacy to a named beneficiary free of Income and Federal Estate Taxes at the owner's death. These guarantees are provided regardless of how the underlying plan assets perform.

How good is the EBIRA? The following comparisons are based on a 70-year-old male in a 45% Federal Estate Tax bracket, a 35% personal Income Tax bracket having an IRA Rollover account of \$1,000,000 growing at 6%.

Comparison Of Gross Annual Distributions				Comparison Of The Legacy Passed Onto The Heirs			
Age	Traditional IRA	Enhanced Benefit IRA <sup>®</sup>	Additional Benefits To Owner	Age	Traditional IRA	Enhanced Benefit IRA <sup>®</sup>	Additional Benefits To Owner
70	36,496	95,812	59,316	70	562,927	1,000,000	437,073
75	253,047	479,060	226,013	75	619,703	1,000,000	380,297
80	538,712	958,120	419,408	80	653,469	1,000,000	346,531
85	905,403	1,437,180	531,777	85	648,373	1,000,000	351,627
90	1,357,028	1,916,240	559,212	90	588,814	1,000,000	411,186
95	1,871,323	2,395,300	523,977	95	469,618	1,000,000	530,382

For those individuals that would like to pass a larger amount on to the next generation, their legacy can be increased without adding to the cost of the program, reducing the annual participant distributions, or eliminating the guarantees that are essential to it's success.

Although qualified plans have never been considered an effective method of transferring wealth, the Enhanced Benefit IRA<sup>®</sup> enables individuals with substantial IRA Rollover accounts to pass qualified plan assets onto the next generation both Income and Estate Tax free.

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# Considering Buying or Selling a Dealership?

## Engage a Dealership Professional!

### UHY Buy-Sell Case Study

"1 + 1 = 3" is an equation used by mergers and acquisitions experts to describe the expected synergies that may be realized when combining the resources of two entities. Recently, UHY Advisors (UHY), a Driving Force Auto Dealer Consulting Group member proved that equation also works in bringing professional services to a dealership acquisition client.

The potential buyer of a well-known local auto dealership worked closely with their UHY advisor to examine the sellers' balance sheet (inventory, fixed assets, parts, etc.) and to help with the execution documents related to closing the deal. The advisor, having not been privy to initial negotiations, was engaged at a point during the negotiation process where the parties had already tentatively agreed on the values to be placed on the assets transferred. One of the assets, Goodwill/"Blue Sky", was priced at approximately \$3.5 million.

The determination of the "Blue Sky" value was based on a one-page valuation generated by a local tax and audit CPA firm. The one-page valuation (based largely on a rule of thumb approach) lacked explanation and was inconsistent with actual valuation principles.

The Driving Force Consulting Group advisor was able to employ the correct "Blue Sky" valuation methodology and calculated a number far less than the tentatively agreed upon \$3.5 million. The client had relied on his own "industry expertise" and a local CPA, who did not have adequate valuation experience. Fortunately, the Driving Force Consulting Group advisor was able to educate the client and his other advisors as to the correct methodology. This "education" paid major dividends in their negotiation process.

After reviewing this approach, the client was able to re-open the asset value negotiations and was able to close the deal at a reduced price, saving nearly \$2.5 million on the "Blue Sky" portion of the transaction! Upon closing, it was apparent that the seller had not engaged any valuation professionals to assist with price negotiations during the transaction process. In the end, a dealership (and real estate) that had initially been valued at approximately \$15 million was purchased for approximately \$11 million. The reduced purchase price was attributed to: 1) the expertise and collaboration of the Driving Force Consulting Group member's tax, audit, and valuation teams; 2) an uninformed seller who decided to "go it alone" without the assistance of a qualified valuation professional; and 3) the buyer's initial offer based on a rule of thumb/ formula-based methodology (e.g., 4 times EBITDA).

In conclusion, the valuation of "Blue Sky" during the negotiation process is a complicated issue that can be affected by many factors. The majority of these factors are not evident in a financial statement and it takes bona fide valuation experts to apply the correct valuation approach.

While the ultimate outcome of this engagement was fantastic from the client's perspective, the process was rockier than it could have been. As in many M&A transactions, the integration of financial and operational due diligence, valuation, financial statement verification, and buyer-seller negotiation, requires a managed and systematic approach that utilizes professionals with the right skill sets (not just those with the available time or the client relationship).

If you are looking to buy or sell a dealership, please make it a point to contact a Driving Force Auto Dealer Consulting Group member (directory of firms on the back) to ensure optimal value in every aspect of the transaction.

## Why Now is the Time to Know What Your Dealership is Worth

Dealership owners often believe the time to determine the value of their dealership is just prior to the sale of their business. And, though it is certainly important to know the value of your business prior to putting it up for sale, valuing a business for sale actually starts years prior to the time frame you intend to pass the baton.

The process of placing a value on your business can help you in a number of ways. For instance, it may reveal areas where you can improve to enhance your dealership's value and offer you a chance to capture maximum value through planning.

### Here are a few areas that can help enhance your dealership's value:

**Transition Financial Statements.** When operating a dealership, most owners want to minimize taxes through a variety of means, including maximizing expenses. While this is a strategic way to show less profit, this is also something that affects your dealership's value and can be an area where, prior to a sale, you may want to change the dealership's overall strategy. Tax strategies can lead to undervaluing a dealership's true value. For purposes of selling a business, higher income levels equate to value. This is why starting a few years ahead of when you actually plan to sell the business can help your sales process.

**Review and Manage Contracts.** Contracts are something that follow a buyer after you sell your dealership. By planning ahead, you can make changes in any and all contracts that may be viewed as less than desirable. Equipment leases, real estate contracts and other supplier contracts may come into play here. Ideally, if you can manage contracts for a favorable transition it works for you the seller, and the new buyer.

**Ensure a Smooth Transition.** Often, key employees hold a great deal of the company's intellectual capital. By utilizing succession planning, you help the

new owner feel more secure about buying your dealership. This is an intangible that offers a real value to buyers. Creating programs that tie employees to the company can also be an effective succession strategy.

**Build in Processes and Systems.** As the owner of a dealership, if you are the chief executive officer, the chief washer and the chief service manager, it may be time to put processes and systems in place. Dealerships that do not have formally documented procedures and established systems can find the asking price negatively affected. Working ahead of time allows you to create systems and processes that will add value to your dealership.

Valuing your dealership offers you the ability to be proactive in your decision-making process. So whether you plan to sell in two, five or 10 years, give us a call so we can help you maximize your asking price. Contact your Driving Force Auto Consulting Group member today.



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address

## It's A Fast Paced World....

Is Your Business Keeping Up?



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