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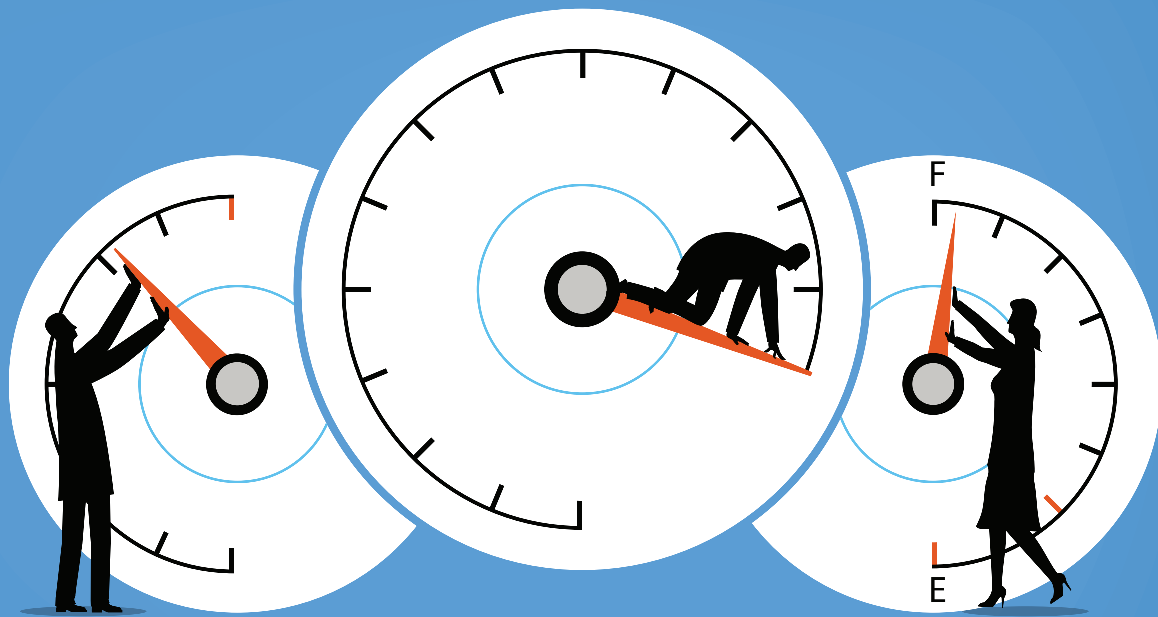

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Think Like a Buyer: Preparing for the Sale of a Dealership

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When purchasing a dealership, whether an asset or stock transaction, buyers typically like to make sure they know what they are buying. They conduct buy-side due diligence to assess the quality of the target's earnings and cash flows, allowing them to identify potential issues or risks associated with the seller's business and its operations.

In the same vein, sellers may also conduct their own due diligence. Sell-side due diligence is not necessarily as commonplace as buy-side; however, it can be just as impactful. In fact, preparing for the sale – before the "for sale" sign even goes up – may greatly decrease the potential of a derailed transaction, avoid unnecessary delays in the sales process and expedite the buyer's due diligence.

What Does Sell-Side Due Diligence Entail?

Sell-side due diligence is gaining momentum, and is essentially identical in concept to buy-side due diligence in that it helps the seller assess and identify issues that may concern a potential buyer. This is especially true in the dealership space where many stores are not subject to annual generally accepted accounting principles (GAAP) audits or reviews. In total, it may provide both the seller and the buyer numerous advantages.

At a high level scope, the sell-side due diligence process includes the following elements:

- Total assessment of dealership financials and operations
- Analysis of the dealership's quality of earnings (QOE)
- Working capital requirement evaluation
- Reasonableness of forecast assumptions
- Tax risk assessment
- Identification and management of relationships – particularly those with manufacturers, vendors, third party service providers (attorney, CPA, etc.)
- Opportunities for the potential buyer to further maximize value
- Human resources evaluation

An Investment that Outweighs the Price

The objective of sell-side due diligence is to allow the dealer to identify issues that would naturally be discovered by a potential buyer during their own diligence. This allows the seller to proactively address these issues and come to the negotiating table armed with well thought out responses. Furthermore, the buyer may be more likely to pay a premium price for the dealership if the dealer is upfront and a well-founded, trustworthy relationship is formed from the very beginning.

While sell-side due diligence is not likely to eliminate the buyer's decision to perform their own due diligence, a sell-side report may help focus a buyers diligence, expedite the sale and assist the seller in negotiating buyer diligence findings that generally work to their advantage to try and drive the price down. Thus, it is imperative that the seller conduct their own thorough analysis.

Take Action

As sell-side due diligence increases in popularity, it is beneficial for sellers to have a basic understanding of what this process should look like. Most importantly, dealers must undergo their own diligence project before brokers are freed to find prospective buyers.

Dealers should consider incorporating the following items into their sell-side due diligence approach:

- Apply a detailed, multi-year approach to gauge the performance of each department in the dealership and how the store's performance compares to industry benchmarks.

- Identify a suitable management team that will be a positive representation of the organization throughout the transaction.

- Assess accounting policies to ensure they are in accordance with generally accepted accounting principles (GAAP) and follow industry norms. Identify internal entries, such as packs and items charged to other income and expense that may affect important metrics such as gross profit.

- Evaluate shared employees and services that exist in multi-store groups and ensure the related expenses are shared appropriately amongst the various dealerships. In addition, identify voids that may need filled post-transaction and devise a plan to assist during the transition.

- Extend your analysis to any reinsurance or retro program relationships that the dealership may have and determine the additional profits that may be generated in other entities. This should also identify product over remits that are returned to the dealer.

- Identify non-recurring or non-business expenses or income to normalize earnings. Such items could be country club dues, litigation settlements, factory payments for facility upgrades, excess wages for family members, non-market real estate lease arrangements, etc.

- Prepare thorough documentation surrounding the issues, pro-forma management adjustments and other impactful due diligence findings to share with potential buyers.

Think Like a Buyer

In many ways, sell-side due diligence relies on the dealer's ability to think like a buyer. In many cases, the process of selling a dealership can be foreign to a lot of dealers. Thus, it can be highly beneficial to enlist the assistance of a professional with experience on both sides of the transaction. Often times, dealers are unable to completely take on the mindset of a buyer as it is easy to turn a blind eye to issues that may occur in their dealership or they are unsure as to how other dealers operate their businesses. Therefore, it is essential to have someone who is well-versed in the buyer's stance and can ask the tough questions that will help uncover potential concerns and risks. Facing the matters beforehand that may crop up in buy-side due diligence will help provide the dealer with the tools they need to navigate the choppy waters of selling their dealership.

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