

### **Critical Issues in Business Valuations and Family Transitions for Auto Dealers**

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Scott A. Womack, ASA, MAFF Senior Vice President 615.345.0234 womacks@mercercapital.com https://www.linkedin.com/in/scottwomack-59a1b638/ Scott A. Womack, Senior Vice President, is active in family law litigation (traditional litigated divorce and collaborative divorce) and corporate valuation and leads Mercer Capital's Auto Dealer Industry team.

Scott assists estate planning attorneys in federal and state valuation matters, family law attorneys in divorce matters (including business valuation, forensic accounting, division of marital estate, etc.), and small business owners involving the potential sale of their businesses. Scott has testified in several jurisdictions involving family law matters. In addition, he has testified in Tax Court.

As the leader of Mercer Capital's Auto Dealership Industry team, Scott provides valuation services to dealerships throughout the U.S. related to corporate planning and reorganization, transactions, employee stock ownership plans, and tax issues as well as valuations of intangible assets, and assets subject to specific contractual restrictions. Scott and his team also consult with auto dealer clients in the process of selling or buying.

Scott's overall valuation concentration includes gift, estate, and income tax planning and reporting (valuation of businesses and business interests); financial Reporting under FASB ASC 350 (goodwill impairment testing- formerly FAS 142), FASB 718 (valuation of stock-based compensation including stock options, restricted stock, stock appreciation rights, etc.-formerly FAS 123R); and holding company valuations (real estate/marketable securities) and fractional interests in real estate.

Scott is a featured speaker for auto dealer industry groups, family law associations, attorneys, accountants, business appraisers, and business professionals on various valuation and financial advisory topics.



# What We'll Cover Today

- Typical Normalization Adjustments for Business Valuations
- Value Drivers of Store Valuation
- Buy-Sell Agreement Issues
- Common Family Transition Issues



#### **SECTION 1**

# Normalization Adjustments in Valuation

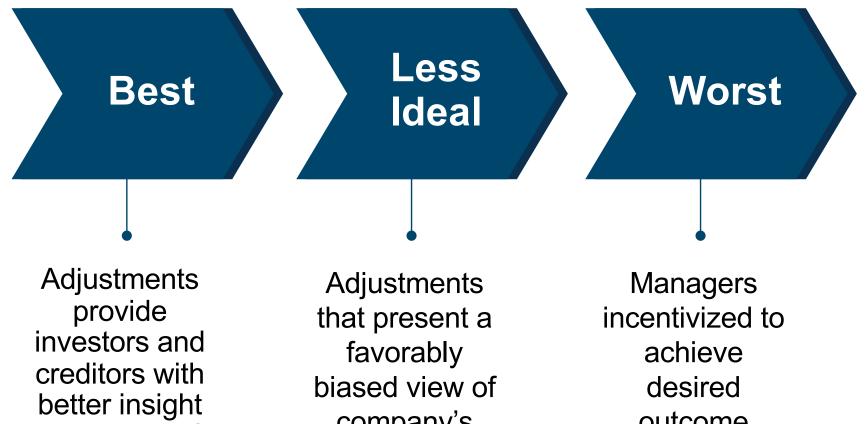


### What's the Point?

- Develop a "public equivalent" for comparability purposes
- Identify significant non-recurring or unusual expenses (or potentially sources of income)
- Determine a reasonable earning power of the Company



### **Management Motivations for Adjustments**



into company's "true" earnings

company's performance

outcome and/or fraud



### Where Do We Find Potential Adjustments

Reviewing trends in the Dealer Financial Statements

• Material fluctuations (\$ and %)

Notes to the financial statements

#### Management interviews and site visits

- It's interesting what may come up during a conversation
  - "As a matter of fact, we did hire a one-time consultant for general business consulting. It was \$100,000. Never again!"

Asking the question: "Any non-recurring, extraordinary, unusual expense(s)?"



# **Types of Earnings Adjustments**

	Description	Examples
Type 1: Non-recurring, unusual items	One-time gains or losses, unusual or non-recurring items, discontinued operations, run-rate adjustments, etc	<ul> <li>Sell a building; remove gain on sale</li> <li>Settle a lawsuit; remove settlement expense</li> <li>Adjust ongoing revenue and expenses for a mid-year acquisition</li> </ul>
Type 2: Discretionary items	Normalizing officer/owner compensation and discretionary expenses that would not exist in a well-run, publicly traded company	<ul> <li>Owner takes distributions in lieu of comp or takes all profit in form of salary; normalize comp</li> <li>Treat owner's condo as non-operating asset; remove related expenses</li> </ul>

See Integrated Theory, 2nd Ed. (pp. 110-114)



# **Common Adjustments**

Balance Sheet

- Inventory valuation method (LIFO v. FIFO)
- Depreciation method (accelerated v. straight line)
- Fixed Assets/Leasehold Improvements
- Goodwill/Other Intangible Assets
- Non-Operating Assets
- Working Capital
- Owner A/R



# **Common Adjustments**

Income Statement

- Inventory valuation method (LIFO v. FIFO)
- Depreciation method (accelerated v. straight line)
- Excess compensation for key people (salary, bonus, dividends)
- Fringe benefits (excess)
- Rent
- Other Income Items
- Discretionary/Non-Recurring/Personal Expenses
- Expected Industry Profitability vs. Actual Profitability



### **Inventories – Balance Sheet**

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6	NOTES RE			0051		1100 0000	na filmlakaan ina caana ayoo oo gaga gaga gag		OTH	HER - SHORT TEP	M	2030	0205
7	Discounted Receivable	NON US)	-   -			1105 0002		)	LON	IG TERM - CURRI	ENT PORTION	2040	0208
8		VEHICLE						TIPA	TALINES	F CREDIT (LINE OF CRE	DIT LIMIT) 0205	• 2055	0208 0209
9	ACCOUNTS	PARTS BC	0063	Ford	1178	EDEA CS	B 117	7 0065	00194	YABLE	- Contraction on	2100 - 2163	307028
10	RECEIVABLE	- construction of		Support			Contraction of the State of the Contract	1180	0017			2200 - 2205	0211
11	<u>الہ</u>		The second second	SESP/FLOOP		ASSISTAN	CE/OTHER	- 1100		3.		• 2300	2631
12	WINAN	CE REC	EIVAB	LES - CUR	RENT			1280	0019	496 R	FUND	• 2010 - 2320	48506
13	ALLOV	VANCE	DOU	BTFUL REC	EIVAB	ES		1290	0020	and the second s		2400-2402	74148
14		Tanaa		1000.0		0082	The State of the starts		0071	983		2410 - 2415	<sup>215</sup> 39299
15	total N and and a sub-	runu		DLINC		OTHER		1300		31340		2450	0210
20	ETRUC	KSFORD	5	9 LINC		DOBS OTHER		1310	0022	236335	7 NÉ	2420	121280
21	DEM	OS FORD		5 LINC	····	0088		1340	0023	and the second		2460	10024
-			an 100			07HER 0090		1330	0024		3 NET		<sup>20</sup> 6081900
22		and the second second	RS	53	60	1		1350		73931	7 AVER		
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25	E Only	state and success to suc	UNS					1388	0.000			141370	0225
26		CA	RS  00	° 14	60	0095		1385	0026	23514	5 LONG	2510	0228
27	VEHICI		CKC 00		DAY	0090		1365	0027	and the state of t	TERM		0227
-			0097	And a property of the second	E 1400.	Note:	-	at . Cambridge	0028	.21326	-	2520	<sup>0220</sup> 528001
28	PARTS	INV,	ONOCO	20915		NON FONDCO		1410		20915	5	2530	0729
29	ALLOW	ANCE -	PART	S INVENTO	ORY AD	JUSTME	NTS	- 鐵	DOOR	4678	11	2540	0230
30	OTHER		TOPIE	5				1440	0030	and the second sec	C	ASE LOSS 2600	0231
								+ 1460	10000	20292	ESTI-	2700 2710	0232
31	LIFO INVI	ENTORY	NEW	49782	1470 US	SED.		1480	0011	349782	DT/	2/10	<sup>2233</sup> 6609901
32	RESE	RVE	PARTS	5				1410	0012	TOO TO REAL PROVIDE A	V T		NET WORTH
33	DREDA	ID EXPE	NECE		C Cold C C Cold				pain		1	2800	240000
35								1500 - 1560	2011	21933	OF STOCK PA	R VALUE 2805	0230
36	TOTAL			SETS					8	156332		2810	0235 2132478
37	LAND ASE	D VEH.	NET	0102		0103		1810	0035	STOC	к	2803	0237
	BUILDIN			UNITS CAR		TRK.		1850	OKLA	SSET REV	ALUATION (N	DN US) 2470	0238
39		VEHIC					1680	1651		DENDS DECL	RED	2820	2239
40	EQUIPME	INT P	ROVE	MENTS - N	ÉT			1700	003/5 0	INVESTMENT		2830	6740
41			Ph-	COST					RIETOR	S DRAWING		2840	p241
42	LEASEHO	0.00	OST	· California and a state				NET INVI					<sup>0242</sup> 2372478
43		AN I	ORTIZE	0		1736 0043	134647	NET PRO	DFIT - AI	FTER INCOME TA	X • YTD	2850	0245 E10470

Asset: **LIFO Inventory** + LIFO Reserve **FIFO Inventory** Liability: **LIFO Reserve** X Corporate Tax Rate **Additional Taxes on FIFO Inventory** 



### **Fixed Assets**

#### If Dealership doesn't own real estate:

# Remove (net of depreciation):

- Buildings
- Leasehold Improvements
- Land

22	NON CARS 0089 5	3 60 0090 13	739317					330370		NET
23	NON CARS 000 5	APPENDIX AND ADDRESS OF ADDRESS OF ADDRESS	139317	the state of the s	THE OWNER WATER OF STREET	TH TOTAL EXPENSE	S	397556		CASH
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25					MOR	GAGES PAYABLE			0220	
	Only) TRUCKS NEW	349782 1470 USE	D	1480	ί –	OFFICERS AND	OWNERS	2510	0227	
27	VE PAR	TS		1490	0012	FORD		2515		
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-	ALLOTAL CURRENT			• 1560	জ্যা	And a second		2530	6130	and the second
30	0					B563 3VEHIC	LES	2540	0731	
31	LEASED VEH NET	UNITS CAR	0103	1810	0035	5551	DN PURCH	ASE LOSS 1000	0232	
326	RENTAL VEHICLES	- NET	164	0 1850	0410	6503		2710		
37	LAND AND IMPROV			1651	0037	0503			- t	609901
	LAND AND IMPINOY	· · · · · · · · · · · · · · · · · · ·		- 1705				2400	NE 2/34	T WORTH
38	BUILDINGS	COST		1710	0038	1610571	TOCK PAR	2800 - 2802	0230	240000
39	abicolitos	DEPRECIATION		1715	Charles Links	1159862	MANUS / /1	ALOE 2000		/#15-00/184688
40		COST		1720	DOLAR.	A CONTRACTOR OF A CONTRACT OF A CONTRACTACT OF A CONTRACTACT OF A CONTRACTACT OF A CONTRACTACT OF A CONTRACTACTACT	1	2803	20237	132478
	EQUIPMENT			- 1722	1001	1251584	ION (NO	Management of the second	0238	
41	-	DEPRECIATION		- 1725	Ĉ.	1072920	I I I I I I I I I I I I I I I I I I I	11 00)	239	
42		COST		1730	0042	181165			240	
43	LEASEHOLDS	AMORTIZED		1735	6100	and the second sec	· · · · · · · · · · · · · · · · · · ·		1241	J
4.	EINIANICE DECENTIA			1800	0044	134647			242 0	272470
43	FINANCE RECEIVA	BLES DEFERRED - NE	1	1805			TD	2850	243	372478 510472
44	RECEIVABLES - OF	FICERS & EMPLOYEE	S	1810	0045	24160			24 0	882950
45	RECASH VALUE - LIFE	INSURANCE		1820	00-18	RTH	and the second	and the state of the	245 O	492851
46 0	CASH ER ASSETS - N	ET		1430	0047	· · ROI		%	9	192031
	o filmer filo			1830 - 1837	-		1992 200 20			입니다. 방법
48	TOTAL ASSEASSETS	양식이가 동목한 관광관		1993 I S	0048 9			2831219		
49	FROZEN	USED VEHICLE INV	ENTORY		DED	MINIMUM OR GUIDE		2215001		
50	CAPITAL PARIS	PARTS INVENTORY	1		OVER (U			616218		
a secold as	ozon capital for doutership) PSB REC	EIVABLES	005	A REAL PROPERTY AND INCOME.	na seriesta S	ACCOUNTS	RECEIVABL			Ĵ
52	ga da adres spana, e	55	C STATE STATE			and the second se	1 - 60	61 - 90	T	91 +
53	OPERATING ANALYSIS	MONTH YTD	MONTH YTD	VEHICLE ACCT	TS	46649	-	0514	0521	
54	SALES	3583040 3697340	52 % TOTAL SALES	PARTS ACCTS	0	01 3 3 7 0 1 0508	<b>BA</b> 4 <b>C</b>	0515 0000	0522	



### **Goodwill/Intangible Assets**

22         NON         CARS         0080         53         60         0090         1330         0002 1         AVERAGE MONTH TOTAL EXPENSES         397556           23         U         CPO         TRUCKS         66         DAYS         0092         1330         0025 1         0.3959.8         NET CASH OVER (UNDER)         141370           24         s         CPO         CARS         0110         COST         100010 GGES PAYABLE         2300         0225           25         E         Only         TRUCKS         0111         S         COST         100011 GGES PAYABLE         2300         0225           26         D         RE-         CARS         DEPRECIATION         1715         DFICERS AND OWNERS         2310         0274           27         VEHICLES TR'         COST         1720         0440         -93         2316         0277	d 7
23         U         CPD         TRUCKS         66         DAYS         DAYS <thdays< th=""> <thdays< th="">         DAYS<td>d 7</td></thdays<></thdays<>	d 7
25     E     Only)     TRUCKS     OFFICERS AND OWNERS     2510     0225       26     D     RE     CARS     COST     OFFICERS AND OWNERS     2510       26     D     RE     CARS     DEPRECIATION     1715     OFFICERS AND OWNERS     2516       27     Ventres trop     OPRO     2516     0227	d 7
26 D RE CARS DEPRECIATION 1715 PRD 2516 0227	,
27 VARAELED	
2/   VERGLES   11'	528001
1/20 WWW a a 2020 Part	320001
28         PARTS IPEQUIPMENT         - 1722         12         - 1722         12         - 1722         12         - 1722         12         - 1722         12         - 1722         12         - 1722         12         - 1722         12         - 1722         12         - 1722         12         - 1722         12         - 1722         12         - 1722 <th< td=""><td></td></th<>	
30 0 NPURCHASELOSS 2000 021	1
31 U LEASEHOLDS	2
32/3 AMORTIZED 1735 AAA 134.64	6609901
44 FINANCE RECEIVABLES DEFERRED - NET	NET WORTH
	240000
45 RECEIVABLES - OFFICERS & EMPLOYEES (#10 0045 241 60 5 248 VALUE 2005	6
46 CASH VALUE - LIFE INSURANCE	2132478
2803 (227)	
47 OTHER ASSETS - NET - 1837 0047 5515 100 US) 2870 038	
GAPITAL         PARTS INVENTORY         0705         20915         2445           4350         0100010000000000000000000000000000000	2372478
44 (Nepsilve arrived a no	510472
45 Rt frozen capital for douterably) PSB RECEIVABLES 2108	2882950 9492851
	9492001
47 OTHER DERATING ANALYSIS MONTH YTD MONTH 2821210	
2031219	
49 ROZEN SALES 3583040 36973462 % ZMOR GUIDE 2215001	
30 (Repute should and 35) 354946 495307 (VER) 616218	
ACCOUNT RECEIVABLE AGING	
371871 CURRENT 31-60 81-90	91 +
53         OPERATING ANALYSIS         MONTH         TOWNRITH         YTD         VEHICLE ACCTS         F000 4 6 6 4 9         0007         0014         0015           54         SALES         3583040         369734621% TOTAL SALES         PARTS ACOTS         0001 3 3 7 0 3 1000         0014         0015         0001	121

#### **Remove:**

- Goodwill
- Intangible Assets

Goal: To conclude a Net Asset or Tangible Value of Dealership



# **Working Capital**

Goal: To assess if Dealership has excess or deficient amount of working Capital

Actual Working Capital

Less: Required Working Capital

Excess(Deficient) W/C

22 23 24	U CPD TRUCKS	<sup>0029</sup> 53 0001 66	60 DAYS	0002 1340 1370	and Deformation	DENDS DE	· · · · · · · · · · · · · · · · · · ·		397556 141370	NET CASH
24	Franchise				RS' OR	INVESTME	T		2000	1225 1228
26	D RE- CARS		60	OPRIE	TORS	DRAWING				221
27	VEHICLES TRUCKS	43	DAYS	0090				5251.522	antes en dete	528001
28	PARTS INV. POWOC	209155	1400, 0090 1405 MONI	TINVEST	MENI					528001
29	ALLOWANCE - PAR	TS INVENTO	RY ADJUS	NET PROFIT	r - Afti	ER INCOME	TAX - YTD			2850
30	OTHER INVENTOR			NET WORTH	_				·····	
31	LIFO INVENTORY			ala Anto a Ato a State a da		• I				********
32 33	RESERVE PAR		-5	TOTAL LIAD	BILITIE	5 & NET WO	RTH			¢ 1
34	PREPAID EXPENSE TOTAL CURRENT		- 1	RETURN ON	INVES	STMENT - RO	1			
35	LEASED VEH NET	0102		No. of the second s						%
36	RENTAL VEHICLES	UNIT & CAR	15	WORKING C	CAPITA	L		and and a second se		
37	LAND AND IMPROV		51	ACTUAL					28312	10
38	BUILDINGS	COST	6 E							to the second second second
39		DEPRECIA	26	RECOMMEN	NDED N	INMUM OR	GUIDE		22150	01
40	EQUIPMENT	COST	5	ACTUAL OV	ER (UN	IDER)			6162	18
41		DEPRECIA			de straag	4000		-	Concerning and the second second	
42	LEASEHOLDS	AMORTIZE					UNTS RECEI	VAB	EAGING	/ 8
44	FINANCE RECEIVA	Concernance of the second s			I . I	CURRENT	31 - 60		61 -	<u>-72</u>
45	and changes and the second state of the second			EHICLE ACCTS	1001	46649	0507		0514	.950
46	CASH VALUE - LIFE	INSURANCE			020	10019	0508	-	0515	£2851
47	OTHER ASSETS - N	ET		S ACCTS		33721	73	46	2	7
48	TOTAL ASSETS			ACCTS	050	2	0509		0518	
49	FROZEN	USED VEH		NTORY	0.50	3	0510	and the second	0617 001	
50	(Negative aniount = no	PARTS INV							016218	
51 52	frozon capital for doutership	PSB RECEI	VABLES		2109	2449	0511		LEAGING	)
53	OPERATING ANA	LYSIS	MONTH	YTD	MONTH Y	TD VEHICLE ACCTS	<sup>6000</sup> 46649 <sup>0507</sup>	- 60	61 + 90 0514	91 • 0521



### **Owner Accounts Receivable**

6	NOTES RE			050		1100	0000	a lako mina manana ana g	۴ O	THER - SH	ORT TERM	1	2030	0205	11+11
7	Discounted Receivable	Noles (NON US)	P n	051		1105	pq01	and the second second second		ONG TERM	- CURREN	NT PORTION	2040	0208	p
8		VEHICL	ΕŚΫ	052	057	65				Inc	LINE OF CREDI	IT LIMIT) 0205	0 2055	0208	
9	ACCOUNTS	PARTS B					-1	-	0011		10	And a frank of the owner of the second se	2100 - 2163	0210 3070	128
10	RECEIVABLE	OTHE	R				J,	2	201	/	ADur		2200	0211	
11	S	INCOLE	D		DEC	3:	12	017	1	1	CITY	STA.	• 2300	0313	531
12	W&PCL	A'	ON HAN							100	0001		· 2310	<sup>6213</sup> 485	
13	R VEHICLS	H			in er en de de sete en					101	0007	375	2400	741	Sec. 62: 202.
14	11110/	-	MONEY	MARK	ET / D	EPOS	ιT			<ul> <li>301</li> </ul>	\$ 0007		241D - 2415	<sup>2215</sup> 392	
15	R LI	INAN	ICE	· NEV	N	" Note to Madinine	and the state of a			102	0003	52754	2450	0216	
16	<b>C</b>										1000	52154	2420	1212	280
17		NTR/	ACIS	- USE	;D					e 103			2460	0218	
15	MAR	KETA	BLE SE	CURITI	ES					164	0005			<sup>20</sup> 60819	00
-	NOT					0050					0000		· .		
6			CEIVAE	SLE						110			13		66
7	Bece	lvable	Noles (NON U	181	P a	0051				110	1000			NET	
8		TI NOIS				0052				111	0000		1-6	CASH	
				ICLE	S U					112		46649	0.0	0225	
9	ACCO	DUNTS	SER	S BODY		0053		177	164	1120	, 0000	210885	A	0228	
10			0.7	HER		0054	UTION Parts Ch		11	20 113	0010		-	0227	
		VABLE	E	nen					11	12 113	5	990940		-	
11			INCON	AE TAX	REFUN	D				1125	0015		10 530	5280	01
29	FW	8 P CI	LAIMS			100 C	uri Libră Maler		1.000	113	0011	2444	- I amount	0230	
30	0									116		2449	5 2600	0231	
31		HICLE	HOLDE	BACK						110	0012	5250	2700 2710	0232	
32		ENTI	VES							1174	0012		2710	<sup>2233</sup> 66099	01
33	ODC:		1174 00	II Ford		1178	8064	CSR	1177					NET WORTH	L L
34	TOTAL GUP			Sup	part	11/6	0004	CSR (FoC)	11/7	6963	1		2800	2400	_
35	LEASED VE	BER	NCENTIN	ESIESP	FLOOR	PLAN	ASSIS	TANCE	OTHER	1180	0017	A PAR VALUE	- 2802	2400	00
36	RENTAL VEH	HICL.		Contraction of the local division of the loc		all and a second second				1214			2810	<sup>0235</sup> 21324	78
37	LAND AND I	MPROVE	(ECEIV/	ABLES	- CUR	RENT				146			2803	0237	10
38	BUILDIN	GS	COS: 00	UBTFU	L REC	EIVA	BLES			1290	REVA	LUATION (NON US)	2470	0738	
39		This Contractor	DEPRECIAT	- 00			0082		to the second		DS DECLAR		2820	2239	
40	EQUIPME	INT	COST		C		OTHE	R	rtS	OR INVE	STMENT	ny nganangan katalan katalangan katalan nganagan nganangan pangan sa	2830	6240	~~~ <b>`</b>
41			DEPRECIATI	ION	Start . The has been more	. 1727	107	2920	PROPRIETO	DR'S DRA	WING	an a	2840	0241	
42	LEASEHO	ins l~	COST			1730 00	<sup>₩2</sup> 18		IET INVESTM	ENT				242 23724'	78
43			AMORTIZED			1735	13	46471	ET PROFIT -	AFTER IN	COME TAX	• YTD	2850	0243 E104	70

Tip: Sometimes items are misplaced or disguised on dealer financial statement to overstate Working Capital

Tip: Ask questions of owner/controller during management interview



### Inventories – Income Statement

#### **Beginning Inventory**

- + Additional Purchased Inventory
- Ending Inventory

**Cost of Goods Sold** 

#### **Shortcut Method:**

Change in LIFO Reserve year ove year

- Increase in LIFO Reserve, • increases COGS and Profits
- Decrease in LIFO Reserve, ٠ decreases COGS and Profits

4	CONTRACTS - USED	<ul> <li>toso</li> </ul>	E B RE	MARKETED VEHICLES	2015 0203 1584343
5	MARKETABLE SECURITIES	- 1011 0005	IRE	CREATION VEHICLES	2020 0204
6	NOTES RECEIVABLE		the	YER - SHORT TERM	2030 0205
7	Biscounted Noles 174 0083 Ford 110	78 8064 CSR (FoC)	1177 0065	(O)	2040 0208
8	of the first statistical shall be a set of the state of t		1110		2055 0208
9	ACCOUNTS/BER INCENTIVES/ESP/FLOOR PL	AN ASSISTANCE/OTH	ER - 1100	3.	2100 0210 307028
10	RECFINANCE RECEIVABLES - CURREN	T	1280	Inoto	2200 0211 2205 0211
11			1.000	730	2300 0212 2631
12	ALLOWANCE - DOUBTFUL RECEIV	ABLES	1290	9831 .	2310 a213 48506
19	N CARS FORD 16 LINC	0082	1300	00721	Z400 0214 74148
	N TOND I O LINC	OTHER	1305	313403	2415 0216 39299
20	ETRUCKSFORD 59 LINC	D065 DTHER	<ul> <li>1310</li> <li>1315</li> </ul>		2450 0216
21	DEMOS FORD 5 LINC	0088	. 1340	AMI I	2420 0217 121280
	interest interest	OTHER	1345	138043 NEI	2460 0218 2465
22	NON CARS 0089 53	60 0090	1350	739317 AVER	<sup>0219</sup> 6081900
23	666 Mar 1000 I	AVE 0092	1360	0025	
2.5		DAYS	1379	1039598 NETC	USED 969466
24	S CPO CARS 0110		1380	0001	26
25	Franchise		1385	0302	56 CASH
20	E Only) TRUCKS				70
26	D RE- CARS 0003 14	60 0095	1385	0020 235145 LONG	2500 0225
~~	PRANTICE LED	1009d		0027 TERM	15 1D 0228
27	VEHICLES TRUCKS 43	DAYS	1365	1213266WABILITI	1515 0227
28	PARTS INV. 10007 209155	00, 0096	1410	209155	528001
-		es MONTONDED	1406	Advanta in the second discourse was	1500 0729
29	ALLOWANCE - PARTS INVENTORY	ADJUSTMENTS	- 1譜	46781)	540 0235
30	OTHER INVENTORIES HEND WORK	***	1440	0030 202027 CCT OSS	
			+ 1460	202927 EST	700 0232
31	LIFO INVENTORY NEV3 49782 1470	UŞED	1480	349782 OT	<sup>2233</sup> 6609901
32	RESERVE PARTS		1410	0012	NET WORTH
10.000					240000
343 36  -	PREPAID EXPENSES		- 1560		so5 <sup>0236</sup>
37	TOTAL CURRENT ASSETS			Color and the second seco	<sup>810</sup> <sup>0235</sup> 2132478
38				00000	803 0237
39	BUASED VEH NET UNITS CAR	0103	1810	in the first buy	Contraction of the second statement of the second stat
40	VEHICLES - NET		1650 1850	DULIO	20 (239
41	EQUIPMENT		1031	and the second sec	100 manual (2014)
42	COSPOVEMENTS - NET		1700	0032 KAWING 21	840 0241
43	LEASEHOLDS				<sup>0242</sup> 2372478
	FINANCE RECEIVABLES DEFERRED - NET			AFTER INCOME TAX - YTD 21	510472
	RECEIVABLES - OFFICERS & EMPLOYEES	1810 0045 241505	NET WORTH		<sup>224</sup> 2882950
27-27-6	CASH VALUE - LIFE INSURANCE	241003		TIES & NET WORTH	<sup>2245</sup> 9492851



#### **SECTION 2**

# Valuation Assumptions Influence Valuation Conclusions



### Formula for Build-Up Discount Rate

Risk Free Rate

- + Equity Risk Premium X Beta
  - + Small Stock Premium
  - + Specific Company Risk
  - **Estimated Discount Rate**
- -Long-term Growth Rate of Earnings
  - **Estimated Capitalization Rate**



### P/E Example – Use of Build-Up or ACAPM

RFR	Risk Free Rate
P/E	Price to Earnings Multiples
ERP	Equity Risk Premium
SSP	Small Stock Premium
SCR	Specific Company Risk
G	Growth

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DISCOUNT RATE SENSITIVITY		DISCOUNT RATES (F	DISCOUNT RATES (R) / PRICE/EARNINGS MULTIPLES						
Discount Rate Components		Low/High	Mid-Range	High/Low					
Risk-Free Rate	RFR	3.0%	3.0%	3.0%					
Equity Risk Premium	ERP*	4.0%	5.0%	6.0%					
Beta	ß*	0.9	1.0	1.1					
Beta-Adjusted Large Stock Premium		3.6%	5.0%	6.6%					
Small Stock Premium	SSP*	2.0%	3.0%	4.0%					
Specific Company Risk	SCR*	1.0%	2.0%	3.0%					
Estimated Discount Rate	R	9.6%	13.0%	16.6%					
less: Estimated Core Earnings Growth	G	3.0%	3.0%	3.0%					
Estimated Capitalization Rate		6.6%	10.0%	13.6%					
Estimated Capitalization Factor	P/E	15.2	10.0	7.4					

\* Seemingly small differences in key assumptions can lead to significant differences in valuation multiples and conclusions



#### 1. Growth Rates

- Avoid high or low
- Sustainability in long-term
- Analysis of other factors such as start-up, early stage, or mature company

#### 2. Annualization

- Avoid annualizing a small sample and less than a year
- Ask for Trailing Twelve Month P&L ("TTM") from company



#### 3. Forecasts

- Ask about underlying assumptions
- Compare/contrast to historical trends and industry performance
- Ask for prior year's forecasts/budgets to assess level of success

#### 4. Divorce Recession

- Doom and gloom in latest year
- Compare to historical trends, future outlook, condition of industry and economy



#### 5. Industry Conditions

- Review and include narrative of industry conditions (IBIS World, First Research, etc.)
- How do industry factors affect the company

#### 6. Risk Factors

- Avoid really high or really low assumptions
- Appraiser should provide general basis for conclusion



#### 7. Multiples

- How applicable are comparable companies?
- Sample size
- Explanation for multiple selected and its position on low, middle, high end of range relative to company's performance

#### 8. Time Periods

- Typically review five years of historical financial statements
- Be cautious of small sample size reviewed
- Explanation of time period selected for ongoing earnings assumption



**SECTION 3** 

### **Value Drivers in a Store Valuation**



### Franchise





### **Real Estate**

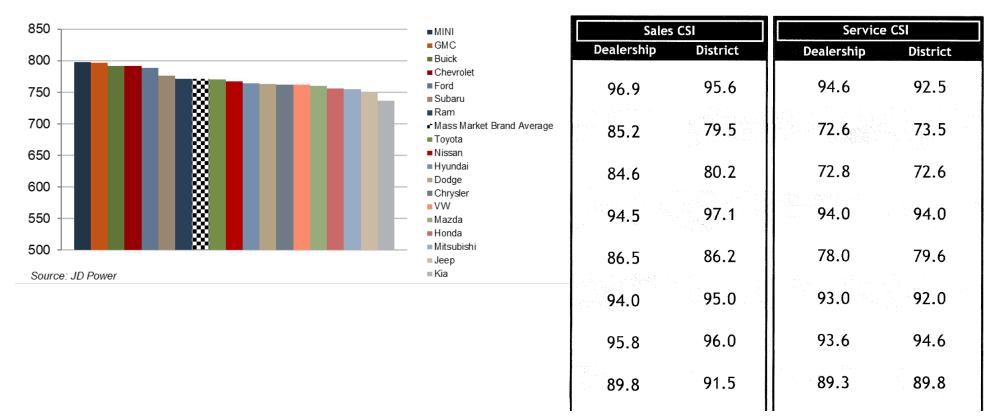
- Owned?
- Leased? From related or unrelated entity?
- Quality of Real Estate
- Signage/Brand Image Programs



Customer Service Index (CSI)

# **Management/Employees**

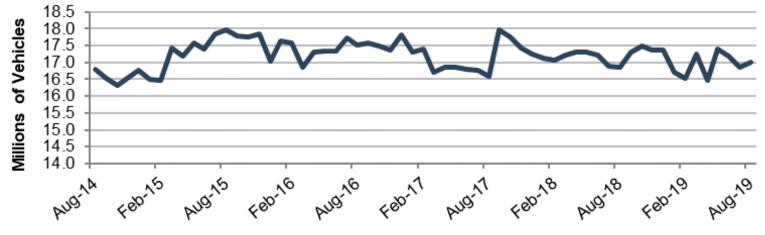
Sales Satisfaction Index (SSI)





### **Recent Economic Performance**

#### **Seasonally Adjusted Annual Rate (SAAR)**



Source: FRED

Local Economic Conditions



### **Other Factors**

- Buyer Demand
- Location/Market
- Single Point vs. Over-Franchised Market

### **Buy-Sell Agreements**

**SECTION 4** 





# What Is a Buy-Sell Agreement?

Agreements by and between the shareholders (or equity partners of whatever legal description) of a privately owned business and, perhaps, the business itself that establish the mechanism for the purchase of stock following the death (or other adverse changes) of one of the owners. In the case of corporate joint ventures, they also **establish the value for break-ups or for circumstances calling for one corporate venture partner to buy out the other partner**.

Require agreement at a point in time	Define the conditions that <b>"trigger"</b> the buy-sell provisions
Relate to transactions that will or may occur <b>at future points in time</b>	Determine the <b>price(s)</b> at which specified future transactions will occur



### **Four Take-Aways**

- Virtually every buy-sell agreement "out there" will not work to provide reasonable resolutions in the event of trigger events
- 2. The **definition of value** in virtually every valuation process buy-sell agreement is **flawed** and will generate valuation problems
- 3. Most buy-sell agreements **will not work** as effective estate planning tools as result
- 4. The **solution** for most agreements is to change the pricing mechanisms to either:
  - a. Single Appraiser, Select Now and Value Now (and Annually Thereafter)
  - b. Choose the Third Appraiser First (this is new!)



# **Potential "Trigger Events"**

- » Q Quits
- » F is Fired
- » R Retires
- » D Disabled
- » D Death
- » D Divorce
- » B Bankruptcy
- » D The D's of Buy-Sell Agreements



### **Questions to Ask Yourself / Your Clients**

# Do your clients have a buy-sell agreement?

If so, what type of agreement is it?

#### Do they know what the buy-sell agreement says?

There are six defining elements that must be in every process agreement if the valuation process and, therefore, the agreement, will work

Do you/they know the estate planning and ownership implications if someone dies or there is another trigger event?

#### How is the buy-sell agreement funded?

How life insurance proceeds are treated can make a big difference in the valuation of the company



### How Do Buy-Sell Agreements Come Into Existence?

#### POTENTIAL OPPOSING SHAREHOLDER CHARACTERISTICS THAT MAKE DISCUSSING BUY-SELL AGREEMENTS DIFFICULT

Characteristic	Shareholder 1	Shareholder 2
Age	Younger	Older
Ownership	Noncontrolling	Controlling
Involvement	Active	Inactive
Personal Outlook	Optimistic	Pessimistic
Investment Type	Sweat Equity	Real Money
Investment Amount	Smaller	Larger to Much Larger
Personal Guaranties	None	Substantial

No one wants to talk about uncomfortable things like dying or firing



## Get Agreement. Now.

# Just Do It.

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## **Types of Buy-Sell Agreements**



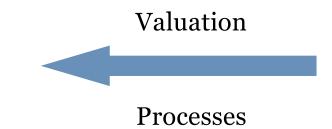
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## **Types of Buy-Sell Agreements**

Based on how price is determined

- Fixed-price agreements
- Formula agreements
- Process agreements





## **Fixed-Price Agreements**

#### Description

The owners agreed on a price.

That price is likely years out of date.

There are three possibilities regarding the price set:

- The value today is lower, perhaps far lower, than the realistic value.
- The value today is higher, perhaps far higher, than the realistic value.
- The value is the same as it was back then.

#### The owners haven't agreed on a way to update the price.

#### **Realities seldom discussed**

If the value is unrealistically low, each owner is betting that the other guy will die first and they will get to buy at the low price. Remember Wayne.

If the value is unrealistically high, each owner is betting that they will be the one to leave the business so he/she and their family can benefit. Remember Austin.

The other owner(s) are making just the opposite bets.

#### Why should the owners take a chance that they'll be on the wrong end of that bet?



## **Fixed-Price Agreements**

#### **Advantages**

- » Easy to understand, easy to negotiate the first time only!
- » Inexpensive
  - Easy for attorneys to draft
  - Easy for owners to understand
  - No appraisers required (not good!)

#### Disadvantages

- » Fixed prices are **seldom updated**, even over periods of many years. Inequities are almost certainly a result of outof-date fixed-price agreements
- » Easy to set an initial price, but may be **difficult to reset as time passes** and interests diverge
- » The longer period of time between updates to fixed-price agreements, the greater the **potential for a divergence of the interests** of the various parties
- » Failure to update price can be disastrous to estate plans of owners

#### How to "fix" an out-of-date Fixed-Price Agreement

- » Update it annually so simple but rarely ever done so ineffective solution
- » Solutions to be



## **Formula Agreements**

#### Description

The owners established a formula to calculate price. Chances are, no one has calculated it lately. Chances are, it can give an unreasonable result now. Combined with changes in the company and the industry:

- The formula price may be higher than a realistic value today.
- The formula price may be lower than a realistic value today.
- The formula price is realistic today.

#### The owners haven't agreed on ways to make necessary/appropriate adjustments.

#### **Realities seldom discussed**

If the value is unrealistically low, each owner is betting that the other guy will die first and they will get to buy at the low price.

If the value is unrealistically high, each owner is betting that they will be the one to leave the business so he/she and their family can benefit.

The other owner(s) are making just the opposite bets.

Why should the owners take a chance that they'll be on the wrong end of that bet?



## **Formula Agreements**

» State a single formula to be applied to balance sheet and/or income statement metrics

#### Example

- » Multiple of Blue Sky (3-5X)
  - What franchise? Source of Multiple
  - Multiple of EBT? Less Debt?
- » Book Value
  - NAV or Tangible Net Value

#### How to "fix" a Formula Agreement

- » Every year, calculate the price based upon the formula
- » What to do if the formula provides result that does not make sense?
- » Solutions to be discussed



### **Valuation Process Buy-Sell Agreements**

#### Description

The owners agreed to let business appraisers set the price for the agreement if and when it is triggered. No one has the foggiest idea what will happen or what the price will be.

No one knows what "kind of value" the appraiser will provide:

- It **could be** the value of an illiquid interest.
- It **could be** the value of the entire enterprise pro rata to ownership.
- It **could be** reasonable and what each owner thought they agreed to.
- It **might not** (probably) be what anyone or everyone expects

## No one will know until the end of a lengthy & uncertain process what the outcome will be.

#### **Realities seldom discussed**

Each owner is betting that the ultimate price will be favorable (or at least reasonable) for them. The company is betting that the process will work and that the price set will be affordable.

#### Everyone is betting and someone will lose.

Good estate planning?



## **Process Buy-Sell Agreements**

A buy-sell agreement provides a valuation process employing one or more appraisers

Value is determined by the appraisers in a manner defined in the buy-sell agreement

Two types of process buy-sell agreements:

#### **MULTIPLE APPRAISER**

#### **SINGLE APPRAISER**



### **Valuation Process Buy-Sell Agreements**

## The valuation mechanism of every buy-sell agreement should be

UNDERSTANDABLE	PREDICTABLE
LIKELY TO ACHIEVE REASONABLE	HELPFUL IN THE WEALTH MANAGEMENT
RESOLUTIONS	and ESTATE PLANNING PROCESSES



**SECTION 5** 

## **Family Transition Issues**



## **Unique Auto Dealer Issues**

- Factory-Approved Dealer Principal
- Second and Third Generation Owners
  - Decision to pass on to next generation or sell
- Active vs. Non-Active Children in Business
  - How to "Equitably" transfer value
  - Operating Entity vs. Real Estate Holding Entity



## Questions

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