

Tips for Buying Dealerships

By Phil Villegas

Ward's Dealer Business, Feb 1, 2009 12:00 PM

If you're in the market to purchase a dealership and have been sitting on the sidelines waiting for the market to bottom out, the next 90 to 120 days may yield some of the best buying opportunities that we will see for a long time. The key to making a good acquisition in this market is to be emotionally and financially disciplined.

Many dealers turned down strong offers only to find themselves now selling their stores for under 60% of what they had been offered less than six months earlier, costing them millions.

Fortunately for buyers, the credit crisis forced pause in sales allowed for pricing multiples to be cut in half.

The second shoe to drop on selling dealers came when most U.S. sales projections for the next year or two were revised to predict either stagnation or decline from 2008 levels.

This allows a buyer to use 2008 year-end financials as a purchase basis, as opposed to a common excuse used by brokers and dealers that the current market is an anomaly and that therefore year-end 2007 financials should be used for pricing.

If you were buying a Toyota store six months ago that was manufacturer image-compliant in a metro market, you could easily expect to pay up to a 10 multiple on 2007 earnings.

If the store was making an adjusted net profit of \$4,000,000, a buyer would be expected to pay anywhere from \$35 to \$40 million in blue-sky/goodwill plus full appraisal on the real estate (approximately \$10 million).

Consequently, a total acquisition cost of \$50 million prior to assets could be expected.

If you were buying that same store today, you can bet the store's net profit at the end of 2008 was off 50% from the previous year's end, leaving it at approximately \$2,000,000. In today's market, due to lack of credit availability, multiples have been cut nearly in half, and as a result this same store would yield a blue sky/goodwill of about \$12 million based on a 6 multiple.

Additionally, due to declines in commercial real estate values, coupled with the fact that banks are holding back on commercial real estate loans, the real estate that was appraised at \$10 million six months earlier can now realistically be purchased for about \$8 million.

A total acquisition cost of \$20 million prior to assets and a 60% discount of the price six months earlier might be expected.

The next few months buyers should consider medium-sized dealerships that can sustain approximately 75 new and used retail sales a month. These stores are better suited to handle both explosive growth and drastic downturns in the economy, while high-volume dealerships have the greatest exposure during economic downturns.

High-volume operations are ones that have higher mortgage costs, higher operating expenses and higher inventory flooring costs, along with higher personnel costs.

A medium-sized store going from 75 to 100 retail sales experiences a 33% increase, for instance, while a high volume store would need to move from 300 to 400 units to experience the same 33% increase.

In the end, a medium-sized dealership can increase sales by 33% without adding significant operating costs or personnel, while high-volume stores need to add layers of cost and personnel.

Finally, buyers should consider targeting single market franchises, along with franchises with low multiples that are viable brands; Ford, Chevrolet, Hyundai, Volkswagen, etc.

For many buyers, it simply makes sense to look beyond the allure of a reasonably priced, high profile dealership in favor of a more prudent investment with good return possibilities.

Good opportunities are coming for those who are willing to look in the right places.

Phil Villegas is a Principal at Dealer Transactional Services, LLC. (an affiliate of Morrison, Brown, Argiz & Farra, LLP) in Miami, FL. He can be reached at PV@D TSAUTO.COM or 305-913-7198.