

DO CONSOLIDATORS INCREASE THE VALUE OF YOUR DEALERSHIP?

As the consolidation of the automobile industry continues, the question that often arises is, "Has my dealership increased in value"? Depending on a number of variables, the answer to that question could be, "Yes"! However, before addressing those variables, it is important to understand what factors impact the value of a dealership.

An automobile dealership's worth, like most companies, is basically composed of two elements: (1) the fair market value of its tangible net assets and (2) its intangible asset value, usually recognized as its earnings capacity, expressed in terms of goodwill or "blue sky". Before the advent of the consolidation movement, most dealerships were bought and sold between existing dealers, and a fairly consistent pattern of the consideration was given for a store.

In most instances, a purchaser would acquire the inventories and fixed assets of a dealership, and the

buyer would pay a multiple of earnings for the "blue sky" of the company. Previously, that multiple tended to range between 1 - 2 times earnings, with some low-performing franchises bringing less and some high-performing franchises bringing more.

However, the entry of publicly traded owners into the automobile dealership industry introduced a new breed of purchaser, and the traditional approaches to purchasing a dealership changed significantly. In the early stages of consolidation, strategic acquisitions were mostly the rule, and prices paid for "blue

sky" produced inflated multiples of earnings that bordered on the absurd. Stock prices of the consolidators were trading at high levels as Wall Street expressed its initial infatuation with the dealer stocks. "Blue sky" multiples between 5 - 16 times earnings were not uncommon. Early dealership sales received high valuations.

Wall Street, as we all know, may be infatuated for a while, but economic reality always wins out in the long term. Accordingly, multiples paid have decreased in recent months, and the consolidators are much more in tune with the earnings capacity of the dealership purchase candidates. Currently, most consolidators are paying multiples of 3 - 6 times earnings, and a number of factors are closely evaluated.

Franchise Mix - Earnings are the key for the consolidators now, and higher earning franchises are receiving the higher multiples.

Dealership Profitability Potential - While historical profitability is certainly important, the consolidators are only interested in dealerships that can generate profits.



Tax Tip

Roth IRAs - An Opportunity to teach a valuable lesson and provide a significant retirement benefit at the same time.

Depending upon where you find yourself in life, encourage your children or grandchildren to set up a Roth IRA. Assume a child or grandchild with an earned income of \$2,000 puts the \$2,000 a year into a Roth IRA for only 10 years, beginning at age 16 (you may have to give them money to fund the Roth IRA). This \$20,000 investment will accumulate to an amount in excess of \$1.3 million of tax-free dollars at age 65, assuming a 10% rate of return.

Dealership Size - Dealerships with high sales volume (greater than \$50 million per year) are clearly more desirable than those producing a smaller sales volume.

Facility Condition & Location - A major factor in an acquisition is the status of a dealership's facility. An outdated facility in an undesirable location can significantly reduce the price the investor is willing to pay due to the substantial amount that will be required to update the facility.

Contingencies - Environmental issues and contingent liabilities (significant dealership litigation, etc.) can also dramatically influence the value of a dealership.

So, with the consolidators playing such an integral role in recent dealership acquisitions, has the value of your dealership increased over what it was worth just a couple of years ago? If you are a large dealership (greater than \$50 million in sales), there is a good possibility that is the case. If you are located in a major metropolitan area, the value increases even more. The ownership of "hot" franchises sold from updated facilities in a desirable location can dramatically increase the worth.

Ultimately, a dealership's value is what a willing buyer and willing seller agree it's worth. The market place, most assuredly, includes the existence of consolidators as willing buyers. However, many factors will influence whether or not a consolidator is a potential purchaser of

your dealership. If not, dealerships will continue to be valued in a fashion similar to that in prior years.

Auto Team America has valuation professionals that may be of assistance should you have any questions. Please call your local ATA office.

ARE YOUR WEBSITE COSTS DEDUCTIBLE?

Website Costs

Most auto dealers either have their own website or are considering having one. Website costs include initial fees for the website design, hosting, maintenance, and support. Costs for a typical website, set up and maintained by a website service provider, could be as follows:

<i>Initial Fees:</i>	
Website Design	\$3,000
Calculator Licenses	\$500
Project Management	\$1,000
Total	\$4,500
<i>Annual Maintenance and Support Fees:</i>	
Website Hosting (\$100 per month)	\$1,200
Website Maintenance & Support	\$1,000
Online Applications Maintenance & Support	\$300
Total	\$2,500

If the dealer has the website in-house there would be expenditures for computer hardware and packaged software. The maintenance and support costs would be performed by dealership personnel.

IRS Deductions

The costs of a website include computer software, page development and design, and maintenance. The purpose of the website is to generate more business and customer satisfaction. Since this is similar to advertising, are all of the costs currently deductible?

Since 1992, the IRS has been vigorously attacking expense deductions because of a lawsuit it won in the U.S. Supreme Court. If the IRS can find any future benefit from an expenditure, it generally considers the cost to be nondeductible. If the cost has a determinable useful life, the IRS will allow the cost to be deducted over the years through depreciation.

For example, a company that incurs design costs for product pack-aging must capitalize the cost of the design, according to the IRS. Pick up any box of cereal, and you are looking at a design that the IRS believes generates benefits over many years to the cereal company. The cost of the design must be capitalized and depreciated over five years. However, at least one recent court decision went against the IRS and allowed a current deduction for the costs. On the other hand, the IRS does not require car manufacturers to capitalize the cost of developing and designing a new car. Here the IRS says that the development and design of a car is in the nature of research and

experimental activities. The IRS allows taxpayers to elect to take a current deduction for all research and development expenses.

What about the cost of computers and programming? Most computer hardware must be capitalized and deducted over a five-year life. Costs of acquired computer software (off-the-shelf) generally must be depreciated over a period of 36 months. However, the IRS just ruled that the cost of developing computer software qualifies for a current tax deduction. The IRS includes these costs in the category of deductible research and experimental costs.

Conclusion

How does this apply to website costs? If your website is developed and maintained by an outside company, you probably will not have to buy any computer equipment or off-the-shelf software. The charges for your website will be for design, development and maintenance. These all qualify for a current tax deduction as either advertising or research and experimental expenses. If, however, you develop and/or maintain the website in-house, and purchase hardware and/or off-the-shelf software, the cost of the hardware and off-the-shelf software should be deducted through depreciation. Either way, any costs for design and development of the website, and the costs for on-going maintenance and support are currently deductible.