WHEN WILL THINGS GET BACK TO NORMAL?

The business world in general, and the automobile dealership in particular, is much different today compared to years past. Many of the practices, strategies and tactics from the 80's and 90's simply do not work anymore; you can't do the same old things and expect different results. We are all challenged to be more efficient, more productive, and more cost-conscious than ever before. All business people, dealers included, must be ever alert to the need for changes in their operating model, and must swiftly make those changes when the need arises. Often it is not simply a matter of profit-protection, but is now a matter of survival.

All areas of today's dealership should be re-examined, or even re-engineered, to eliminate waste, inefficiency, and lost profits. In order for each employee to be as productive as possible, the use of technology must be maximized. The industry demands it, and the dealership's very survival depends on it. As an effort to help keep up with the demands of the new age, here are some areas that should be examined in today's dealership:

Pay Plans and Personnel

The pay plans in a dealership should be re-evaluated at least once a year to make sure that they are appropriate. The plans must include pay rates and incentive mechanisms to reward those who generate profit, and to penalize those who do not. Pay plan scrutiny should apply from the front door to the back - from vehicle sales to the fixed operations. Office staff pay plans should be evaluated, also. Those dealerships that do not reward the producers will see their profits, and their market share diminish.

Technology

The dealership of today has at its disposal increasingly more efficient tools than ever before. CD archiving can reduce storage space and make record retrieval more efficient than ever. Customer tracking and retention systems give today's dealership more and better insight into its customer base than was imaginable just a few years ago. The Internet also offers many more opportunities that were not available a few years ago. It is not unusual for today's dealership to have its e-commerce department rank as its vehicle sales leader for consecutive months. Dealerships trying to survive in today's environment must maximize their use of technology, or risk getting left behind in the race for survival.

Products

Dealerships today must be more aware of changing market conditions, and change their product mix accordingly. Credit life, credit disability, extended warranties, etching, paint sealant, GAP coverage, tires for life, maintenance for life are just a handful of the products being offered in today's dealership. It is critical for today's dealer to not only offer the right products, but to offer them in the right way.

These are just a few of the areas that must be dealt with. Today's customer has more information and more options than ever before. The profitability of today's dealers depends on their ability to find the customer, attract that person to the dealership, offer the right product at the right price, and then fairly compensate the employees. All of this must be done as efficiently as possible because this is the new normal.

For help in evaluating your dealership model, please contact your Auto Team America representative today.

☑ QUICK CHECK

Have you reviewed your computer security guidelines recently?

- Make sure your dealership employees have access to the applications that they need and *only* those applications.
- Each employee should have their own password, which should be changed often.

WHAT'S YOUR STRATEGY FOR ACQUISITIONS?

If you determine that an acquisition is a logical next step for your organization, having a plan in place is critical. Numerous steps must be taken prior to the closing, and failure to plan can lead to unexpected costly results. Many falsely assume that coming to an agreement on a price is all that is needed to make the deal happen, when this may only be the simplest part of the transaction.

Form a Team

The buyer should retain the service of an attorney and an accountant experienced with dealership acquisitions. Attorneys and accountants that have past experience with multiple dealership transactions can provide the best guidance and ensure that the process is as smooth and simple as possible. Experienced professionals may also already have a relationship with the factory that can expedite the process. Meet with these advisors early in the process to share your thoughts and find out what information you should be asking for or looking at during the acquisition process.

You also need to contact your bankers to let them know that you are considering an acquisition. This step is even more critical if you need bank financing to complete the transaction. If the bank will not provide financing for the transaction or provide the floor plan, there is no reason to move forward.

Your internal financial personnel can also be an invaluable resource throughout an acquisition; they are already on the payroll, so their services come at no additional cost. Conversing with your CFO/Controller is particularly important if you are planning on using cash that is in your current business. At the very least your CFO/Controller should be able to provide guidance about future cash flow needs of your current business.

Know the Factory Requirements

The first and most obvious requirement is whether or not you can afford to purchase your new dealership. Once that determination is made, you must decide whether or not you can properly capitalize your new business. Finally, you must determine if you can meet the factory requirements. Most of the factories will require at least two years of financial statements, CSI scores, and factory objectives for your current dealerships as part of the approval process. They also have strict capitalization policies, so if you are planning to finance the acquisition be sure to have a clear understanding of what the factory's capitalization requirements are.

Data Required

The selling dealer most likely will not let you do in depth due diligence until a purchase and sale agreement is signed. The seller generally wants the process to be secret until a firm agreement is in place and they can tell their employees with certainty that a sale is pending. However, there are many steps that can be taken without the seller having to let their employees know that a sale is in progress. Even the most straightforward transaction can take several months, so patience is a critical element of the process. Once you find a target that is prepared to sell, several steps should be taken prior to making an offer.

Beyond requesting factory financial statements and thirteenth month entries, the buyer should request at least two years of CSI scores, factory objectives, CPA prepared financial statements, tax returns and CPA prepared adjusting entries. The purchaser should also inquire about any recent government audits (i.e. income tax, cash reporting, sales tax audits, etc.) and determine what the outcome was of these audits.

Analyze the Data

The current dealer's CSI and factory performance are significant factors in making an offer. If CSI scores are poor, this could mean that you will have to make significant investments to improve these scores. Likewise, if the current dealer is not meeting factory unit objectives, careful consideration should be given to why the dealer is not meeting these objectives. Poor performance in these categories can be indicative of a bad management team or some other factor that will require your immediate attention once you take over. Conversely, if CSI scores are high and factory objectives are met or exceeded you can likely assume that a good team is in place and little additional investment will need to be made to improve the point.

Because a significant portion of your offer will be for goodwill that is usually predicated upon an earnings multiple, it is absolutely critical that the numbers you are reviewing are accurate. If the year end thirteenth month entries and/or CPA prepared adjusting entries are significant, less reliance must be given to the internal factory financial statement.

Prepare the Offer

The offer should be explicit and clearly outline what you are buying and how you expect assets to be valued. A clear offer will eliminate confusion in the long term and sets expectations for the seller. This is a significant variable, with significant tax and legal implications that should be discussed with your attorney and accountant in depth. Since your initial offer is most likely the starting point for a series of counteroffers, patience is critical during this process.

For more information, please contact your local ATA representative.

TAX TIP

SELF-RENTAL RULE REGULATIONS

Real estate on which dealerships operate is usually owned by the dealer outside of his or her trade or business. Under IRC Section 469 a rental activity is defined as a passive activity, and losses from a passive activity can be used only to offset passive activity income, not income from other sources such as salary and dividends. The IRS has the authority to prescribe regulations necessary to carry out provisions of this section and has promulgated regulations requiring net income or gain from a limited partnership or other passive activity to be treated as not from a passive activity.

Unless the taxpayer qualifies as a real estate professional, income from rental real estate is considered passive activity income regardless of the taxpayer's level of involvement in the property. However, the recharacterization or self-rental rule provides that income from rental realty is not passive income if the property is rented for use in a trade or business activity in which the taxpayer materially participates for the tax year.

Thus, the self-rental rule blocks a taxpayer with passive activity losses from one activity from artificially creating passive activity income from another activity in order to absorb the losses.

The regulations treat a taxpayer as participating in a C-Corporation subject to the Passive Activity Loss rules (i.e., a C-Corp that's closely held), so the self-rental recharacterization rule applies if the taxpayer rents property he owns to a closely held C-Corporation in which he materially participates.

For more information regarding self—rental regulations, please contact your local ATA representative.