Morgan Stanley

Shifting Gears: Planning for Powersports Exit & Succession in Today's Environment, Part 1

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In Part 1 of our article, we will discuss the following key takeaways:

- Plenty of opportunities remain for both buyers and sellers. However, there's more to an offer than just the price.
- Don't try to time the market. The right time to sell is when it's best for you, your family, and your management team.
- In some cases, an internal transition is preferable to a third-party sale. But this type of exit requires just as much advanced planning.

We have clearly reached an inflection point in the powersports industry. The economy has held up better than many of us expected, but higher interest rates and general uncertainty have slowed the powersports business after years of unprecedented profitability. What does that mean for the value of your dealership? Is the window closing on exit opportunities?

George Chaconas, Senior Partner of the National Harley-Davidson & Powersports Dealerships Division of Performance Brokerage Services, told us on a recent webinar we hosted that he's seeing more sellers than ever entering the market. Meanwhile, he said buyers are slowing their pace of acquisitions because dealer profitability is down, they have more sellers to choose from, and higher interest rates are having a negative effect on dealership valuations and related real estate.

Opportunities remain for buyers and sellers

That being said, Chaconas believes now can still be a good time to consider exiting. Lots of money remains on the sidelines and today's buyers tend to have strong balance sheets. That bodes well for sellers. Meanwhile, it's a great time to be a buyer, Chaconas noted, because there are far more dealerships available than there were during the pandemic when dealers wanted to keep riding the wave of money, rather than exit. "Now our dealer clients are normalizing to those numbers, so it's still very tricky to value these businesses," he said. Chaconas is advising buyers to do their own pro formas so they can "back into a number that they're comfortable with" based on the ROI they're mandated to get. "We feel 2024 will still be a very active year and we're excited to help both buyers and sellers," asserted Chaconas.

Near-term economic forecast and impact on dealerships

Paulina Matel, CFP®, Financial Advisor for the Stanek-Haack Group at Morgan Stanley stated that Morgan Stanley's outlook for 2024leans toward a soft landing prediction with only a 30% chance of recession. "We're expecting muted GDP growth with inflation continuing to fall amid a more accommodative monetary policy from the Fed," said Matel. "Typically, that would mean lower interest rates starting at some point in 2024," she added, which generally bodes well for both buyers and sellers.

Meanwhile, Matel cautioned dealers not to count on a huge economic rebound to ignite dealer profits and valuations like we saw in 2021 or 2022. "Your value will have to come the traditional way," said Matel, "from a solid marketing plan, from adding lines acquisitions, and from other things you may have more control over internally as an owner." And if the markets soften, Matel suggested building out your pro forma financial statements. "This will allow you to compare your dealership's worth today to what it might be worth a few years out. Then you can determine whether it makes sense for you to stay at the helm for a few more years."

Dealership valuation considerations

Chaconas' colleague, Courtney Bernhard, a Partner at Performance Brokerage, said buyers, sellers and advisors alike are finding it challenging to make valuation calculations. That's because the COVID-year numbers are smack in the middle of the five-year period buyers typically use to assess a seller's "normalized" performance. She feels buyers are putting less weight on the COVID years, and realizing the market is normalizing. Most buyers are looking back as far as 2018, said Bernhard, to get a better sense of a dealer's historical performance.

There's both an art and science to valuing dealerships, noted Bernhard. "We're taking into consideration many factors that affect a dealerships performance, past and present when preparing our valuation and know that a buyer will also do their own pro forma. Chaconas went on to say that multi-line dealerships are still doing very well but "we are beginning to see pressure from the OEM's for dealership performance and to bring the dealership to image compliance.

In my own experience, a dealership's value is composed of several key buckets including cash, multiple of cash flow, short-term assets such as inventory, furniture, fixtures and equipment, and liabilities. Then it's a matter of determining how those different components fit together.

When it comes to goodwill, Bernhard said you must consider the value of a dealer's location, reputation, and franchises under one roof. "Once we arrive at the goodwill number and come to an agreement on it, then everything else falls in line," said Bernhard. "When talking to dealers about goodwill, they sometimes have an arbitrary number in their head that they may have got from a local broker who may not have much if any much experience in pricing dealerships," she said. "Everything has inherent value -- furniture, fixtures and equipment, plus other assets sitting on a depreciation schedule. Each dealer depreciates those items differently. These are things we can negotiate."

According to Bernhard, you also want to look closely at parts, accessories and general merchandise. "I'm passionate about this part of the dealership because it's typically overlooked and never up to date.," related Bernhard. "There's a lot of money sitting in parts. But with parts becoming obsolete faster than before, buyers are becoming more conservative when it comes to valuing parts you have in inventory. Sellers should do an annual physical inventory and take advantage of any tax write-offs for obsolescence," she asserted.

Company vehicles and trailers also come into play. "Often the vehicles and trailers sit on a depreciation schedule, but we negotiate those items separately and make sure no stone is left unturned," said Bernhard. And then you have major unit inventory. "Most new units are sitting on a buyer's new floor plan," observed Bernhard. "Anything that's owned, whether it's new or pre-owned, has equity that can be negotiated," she explained. "And then you have real estate, which can be the biggest part of the transaction and is typically sold at appraised value. All those things add up when looking at the seller's final walkaway number," Bernhard concluded.

In our own experience, you don't want to overlook cash and accounts receivable, either. In some industries a buyer requires a certain amount of operating capital as part of an asset sale. In other industries the seller can get credit for all accounts receivable and cash. In the powersports industry, Chaconas said the seller traditionally keeps the cash and cash equivalents and will pay all the accounts payable at closing. That's because there's usually not a lot of A/R in these types of businesses. "When it comes to parts, it's very important to do a physical inventory every year to keep everybody honest," stated Chaconas. "You want to keep your inventory clean because we're seeing more negotiation than we used to on aging and non-moving obsolescence parts."

When looking at other assets on a dealer's books, I have found that the book value of the equipment isn't necessarily its market value. That's why inventorying all areas of your business is critical from time to time.

Internal transfer of the business

When looking at your succession plan, some of you may be leaning toward an internal transfer of your dealership rather than selling to a third-party. This can make sense if you want to stay involved in the business you worked so hard to build and if you have a very strong general manager or family member capable of assuming the reins of the dealership. Transferring internally can't be done with a handshake, however. It requires a formal plan just like getting ready to take your dealership to market. You also want to look very carefully at your successor's strengths and weaknesses.

For instance, your potential successor may be a great salesperson, but not good at reading financial statements and those skills gaps need to be filled well before the transfer. Bernhard said one thing dealers often overlook in an internal sale is how the marketplace views them, especially if they're not members of the owner's family. "Even if he or she is an excellent general manager, they may not be approved by the manufacturer due to their credit history, their background checks, or some other blips they've had during their career." Bernhard noted. "Full transparency is important between all parties involved. Confidentiality is important and while it may seem exciting to announce a sale, it can cause unrest with employees. An internal sale should be treated like any other sale and kept quiet until the deal is close to being complete.," she concluded.

You also want to look carefully and the financial planning goals of the seller vs. the buyer. For example, in an internal transition, the seller wants to maximize the proceeds from the dealership sale, which if fair since it's their life's work, noted Matel. "They want to take on less risk as they're stepping away from day-to-day responsibilities. They also want to ensure that they get paid if the dealership is sold on a note and there are installment payments in the future," she observed. Over time, Matel said sellers rightfully want to see the personal guarantees removed. Matel said good advisors will take the time to learn about both the buyer's goals and the seller's goals to ensure they have enough in common and that the dealership cash flows can support that transaction.

Assuming everything is in alignment, the next step is to put together a buy-sell plan for the parties involved. "Typically, this is where you see an attorney step in," noted Matel, adding that the plan will also include a shareholder agreement and a share purchase agreement. "Things like the employment agreement for the successor get addressed in those documents, as well as death and disability provisions, the purchase price of any shares transferred to the successor, plus termination of employment and even the life insurance needs of the surviving partner and spouses who may be impacted by the transaction," she said.

As you may have noticed, the process for an internal transition is very different from a third-party sale. In a third-party sale, Matel said you typically see a nondisclosure agreement so financial documents can be shared with potential buyers. If there is an offer, you typically get a letter of intent, and then the transaction is typically finalized with an asset purchase agreement.

In Part 2 of this article, we'll discuss the need for a formal written plan, having an advisory team with industry experience, and common mistakes to avoid when preparing for sale.

Conclusion

If you're considering an exit someday, sign up for a complimentary **30-minute consultation** to discuss your options with Stanek-Haack Group . NPDA members can also receive a complimentary **Second Opinion** .

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