Morgan Stanley

Passing the Torch

Helping ensure success across generations in your equipment dealership, Part 1

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Key Takeaways

- You can't plan far enough in advance when it comes to your exit or succession plan. Involuntary events often alter the timetable.
- Make sure your advisory team (CPA, attorney, banker, broker, etc.) has transaction experience and familiarity with the equipment industry.
- With 80% to 90% of your net worth on the line, don't take shortcuts or try to handle your exit on your own.

According to the Exit Planning Institute (EPI), two in five (40%) family-owned U.S. businesses transition to the second generation and 13% are passed down to a third generation. We suspect those numbers are even higher for AED members. Yet EPI data shows half of owners intending to sell do not have a formal succession or exit plan in place. Nor do they have an experienced advisory team to guide them.

Just because you have responsible adult children working in your dealership, don't assume they want to take over even if they're hinting they do. If you're like most owners, you have 80% to 90% of your net worth tied up in the dealership you've worked so hard to build. Don't let insufficient planning cause you to leave millions of dollars on the table or settle for a so-so offer under duress.

We get it. Most of you have your hands full running day-to-day operations. It can be hard to see the urgency of planning for a transition that may be many years down the road. "But that lack of planning comes with consequences for you and your family," noted my colleague Paulina Matel, CFP®, Financial Advisor, Stanek Group at Morgan Stanley, on a recent webinar we did together. She pointed to EPI data showing that four out of five (80%) owners approach an exit with no written plan, and 78% have no formal advisory team to help with the transition. Perhaps that's seven out of eight (88%) owners who exit their businesses are not satisfied with the outcome, according to EPI data.

Don't settle for those odds.

EXIT PLAN AS A CONTINUITY PLAN

A written exit plan, said Matel, is not just a document you draft when you're thinking of selling; it should be viewed as a "business continuity plan" that not only "maximizes the value of your life's work," but protects your most valuable asset so it can transfer smoothly to NextGen or a trusted employee.

"In a perfect world," said Matel, "you will sell your business on your terms and timetable." But according to EPI, 70% of all privately held businesses – seven out of ten! -- are transacted because of involuntary events that either force the owner to accelerate their exit decision or to make significant concessions along the way. "Those involuntary events," said Matel, "could include everything from death and disability, to divorce or even disagreement." Again, when the vast majority of your net worth is tied to your business, "can you afford to have your life's work exposed to these risks?" she asked.

KEY COMPONENTS OF AN EXIT PLAN

In my experience, a proper exit plan will not only account for the value of your business today; it will account for the tax and financial implications associated with your business entity at the time it transitions to a family member or a third-party. Also, the written plan will explore the right options for your family, whether it's through a planned exit or due to unexpected circumstances beyond your control. It's best to have your exit scenario in place well before you must make such an important decision -- even if that timeline is five, ten or more years down the road.

There are three main ways to transition your business to a new owner:

1. **Internal transfer.** You can transition ownership to your managers and employees via an employee stock ownership plan. An ESOP allows them to take over with little or no money upfront, because most employees can't afford to buy you out at once.

2. Family/ employee transfer. You can transfer the dealership to the next generation in your family or a key employee.

3. Third party sale. You can sell to an outside buyer or buyer group.

So, how do you choose the right succession and exit options?

According to Matel, you first want to identify your financial and personal goals, including how you'd like to spend your time post-exit, where you'll be living and who you'll be spending your time with. It's not easy to do this analysis on your own – especially with a demanding business to run. That is why you need the right advisory team to assist you. As mentioned earlier, 78% of owners try to exit their businesses without a formal advisory team in place -- and EPI data shows the odds of success for do-it-yourselfers hasn't been good. Don't fall into that trap. "Start now, even if your exit timetable is years down the road," advised Matel. "You want to give yourself room to maneuver if life circumstances change your timeline."

Real world examples

Paulina and I started working with an RV dealership three years before the owner had planned to exit. The goal was to transition the dealership to the owner's son who was the dealership's general manager (GM) at the time. We spent a lot of time with the family clarifying both the owner's goals and the son's goals. Initially the son was enthusiastic about taking the reins, but about 12 months into the process, he told us: "I like being GM, but I don't want the financial responsibility that comes with ownership. I can't do it." It was a surprising development, but it gave us two full years to pivot, and the family eventually sold the dealership successfully to a third party. The happy ending wouldn't have occurred if we'd been under a tighter timetable, which unfortunately, is all too common in this industry.

In another case, a John Deere dealer we were working with was planning to transfer the business to his kids. Through our process, however, we learned that the son who was most involved in the business was more passionate about cooking than he was about running a dealership. If you're passionate about being a chef and you have one foot out the door, how well can you run that dealership? Without several years of advance planning behind us, the dealership would have come back to mom and dad when they had already started moving on with their lives. Fortunately, we had enough time to pivot, and found an alternative ownership strategy for the dealership since none of the other children had the experience or interest to take over.

FIVE EXIT AND SUCCESSION CHALLENGES FOR DEALERS

Pat Albero, **Senior Partner, Commercial Truck & Equipment Divisions of** Performance Brokerage Services, Inc. the highest volume dealership brokerage firm in North America, believes dealers must be cognizant of five important challenges with respect to the exit process. Glossing over any of these challenges, he said, can diminish your odds of a successful transition.

1**. Time.** It takes time to put the written plan together and to have those hard conversations with family members about who should be the successor of the business – if anyone.

2. Expectations. If family members are interested in taking over the reins, Albero said you must ask if they are willing to carry that liability forward. He said you must also determine whether the current owner is willing to hold liabilities during that transition process and to meet the manufacturer requirements necessary to turn the business over to a family member.

3. Recasting the financials to conform to the way an independent, bottom-line oriented owner would run the company – not a family business.

4. Assembling the right team. Your longtime CPA, attorney and banker, may not have dealership transaction experience or be familiar with the nuances of equipment dealerships. Albero said it can take time to assemble the right experts who do, and you can't rush the process. The team also needs a quarterback, typically the financial planner, to make sure everyone is on the same page and working collaboratively on the owner's behalf.

5. Confidentiality. As Albero noted, the issues above are very delicate. If they're not handled the right way, the business can suffer and employees, vendors and potential buyers can start to panic.

FINANCIAL CONSIDERATIONS

Matel said the best approach is to start with the end goal in mind. “The exit plan should not only address how your business will sell or succeed, but what you the owner will need out of the transaction to feel financially secure,” she said. “If you are no longer the owner/shareholder to the corporation, and you don't have a W2, or a distribution, or a dividend or a salary, how are you going to support your retirement?” Matel asked. “How much liquidity do we need out of the transaction, after all the costs are accounted for, to support your new lifestyle?”

According to Matel, one of the most important steps for owners is to calculate their “***number***.” That’s an independent and professional valuation of the dealership (and related real estate) that you're considering selling. “You and your advisors will have to sit down and determine whether that estimated sale price provides you with enough liquidity to support your post-exit lifestyle after taxes and deal costs have been netted out,” asserted Matel. She explained that’s your “walkaway” number, i.e., how much goes into your bank account. And that number is more important than the offer price. Matel said it's not unusual for dealers to get a valuation that’s much lower than what they anticipated. Our team spends a lot of time helping dealers look for ways to increase the value of their dealership before going to market and to create a timetable that will close the gap between what the dealership is worth today, and what they think they’ll need to make a sale worthwhile.

We’ll talk more about tax considerations and tax planning in Part 2 of this article. We’ll also take a close look at the key drivers of dealership value, when to start assembling your team and the importance of staying focused on operations during the months and months of negotiations.

NOTE: We’re offering AED members two complimentary meetings to get the foundational blocks in place for a successful exit someday. The first is to make sure we understand your goals and the structure of your business entity. In the second meeting, we provide you with a written roadmap for your eventual exit and succession. Those conversations are had in confidence, and they will also include an opinion of value for your dealership.

Schedule an Appointment Here:

CONCLUSION

Transitioning your business – your life's work -- is a once-in-a-lifetime transaction for most of you. The process can be intimidating, so don't try to do it yourself. The earlier you can start the process, the more time you'll have to draft the right exit plan, to assemble the right team, and to find the right buyer, family member or manager to take over. Doing so significantly increases your odds of maximizing proceeds and minimizing taxes.

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