

Automobile Dealerships – Valuing Blue Sky

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Blue Sky is the intrinsic value of an automobile dealership, over and above the value of its tangible assets. It is sometimes equated to the goodwill of a car dealership.

Most articles regarding the blue sky value of new car dealerships cite a multiple of earnings formula, such as three times earnings, four times earnings, and so forth. The idea that “blue-sky” can be determined by anything times anything is just plain wrong.

Even NADA the ***National Automobile Dealers Association*** in its publication entitled “*A Dealer Guide to Valuing an Automobile Dealership*,” NADA June 1995, Revised July 2000 bemuses, in part, with respect to valuing a dealership by using a multiple of earnings: A Rule of Thumb valuation is more properly referred to as a “greater fool theory.” “It is not valuation theory, however.”

In its Update 2004, NADA omitted its reference to “fool”, but referred to the multiple formula as rarely based upon sound economic or valuation theory, and went on to state: “If you are a seller and the rule of thumb produces a high value, then this is not a matter of great concern. Go for it, and maybe someone will be stupid enough to pay you a very high value.”

A dealership’s blue sky is based upon what a buyer thinks it can produce in net profit. If potential buyers think it cannot produce a profit, the store will not sell. If it can produce a profit, then variables such as desirability of location, the balance the brand will bring to other existing franchises owned, whether or not the factory will require facility upgrades, and so on and so forth, determine whether or not a buyer will buy that particular brand, in that particular location, at that particular time.

I have been consulting with dealers for nearly four decades and have participated in over 1,000 automotive transactions ranging from \$100,000 to over \$100,000,000 and have never seen the price of a dealership sale determined by any multiple of earnings unless and until all of the above

factors have been considered and the buyer then decided he, she or it was willing to spend “x” times what the buyer thought the dealership would earn, in order to purchase the business opportunity.

To think otherwise would be to subscribe to the theories that (1) even though you think a dealership could make a million dollars, the store is worth zero blue sky because it made no money last year; and (2) if a store has been making \$5 million per year you should pay say 3 times \$5 million as blue sky even though you think you will not produce that kind of profit. Both propositions are absurd. If a buyer does not think a dealership is worth blue sky, then what he is really saying is that he sees no business opportunity in the purchase and therefore, in my opinion, he should not buy the store.

Each dealership is unique with respect to its potential, location, balance that its brand brings a dealer group, and condition of facility. The sale is also unique with respect to whether it is a forced liquidation, orderly liquidation, arms length, insider, or a case where an anxious buyer is trying to induce an unwilling seller. There are management factors to consider, length and term of leases, possibilities or non-possibilities of purchasing the facilities and whether or not the factory wants to relocate the store or to open a new store up the street.

In the car business it is impossible to pick a dealership or a franchise out of a hat, multiply its earnings by some mystical number and predict either what the dealership is worth, or what price it would sell for – and it doesn’t matter if you are talking about a Toyota, Honda, Ford, Chevrolet, Chrysler, Dodge, or any other dealership. At any given time one franchise might be considered more or less desirable than another, but they are all valued in the same manner.

Starting in 1972, Mr. Pico entered the automobile business with his law firm representing such groups as Tasha Corporation (once the 17th largest group in the country before it sold to AutoNation), and handling sales such as Lucy DiGuilo’s sale of her deceased husband’s share of Prospect Motors (then the largest General Motors Dealership in the nation) to Skip Halverson.

Before retiring from the active practice of law in 1980 Mr. Pico and his law firm represented numerous automotive dealers in the reorganizations,

purchases, and sales of dealerships. He both tried cases as the attorney for the dealerships and arbitrated and mediated dealer related cases.

Mr. Pico built upon his experiences and became a student of the industry by receiving training and attending seminars with respect to the various departments in new car dealerships, participating in National Automobile Dealer Association (NADA) Management Education Program, having "hands-on "experience" operating a store by filling in as General Manager on an "interim" bases. In 1986, after five years of research and two years of writing, Mr. Pico authored and National Legal Publishing Company published the nation's first book on Buying and Selling Automobile Dealerships.

Mr. Pico is recognized as an expert in the field of buying, selling and investing in automobile dealerships. In addition, both State and Federal Courts have also recognized Mr. Pico's expertise and in various legal proceedings he has been:

- Approved by the U.S. Bankruptcy Court, 10th Circuit, District of Colorado, pursuant to Rule 202 of the Bankruptcy Code, as "Consultant to Debtor" in sale of a new car automobile dealership;
- Approved by the U.S. Bankruptcy Court, 9th Circuit, Northern District of California, pursuant to Rule 202 of the Bankruptcy Code, as "Consultant to Debtor" in sale of a new car automobile dealership;
- Approved by the U.S. District Court, 8th Circuit, Wisconsin, as Arbitrator/ Appraiser in new car Dealership litigation;
- Approved by the District Court of Colorado as expert in dealership valuation litigation;
- Approved by the Superior Court of California as :(a) "Consultant to Court Appointed Receiver" in check-kiting case,(b) "Expert Witness", with respect to dealership valuations, and(c) Superior Court Mediator in dealership/lender litigation.

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