Is Now the Right Time to Buy a Car Dealership?

By John Pico J.D. and Joshua Pico
Article Word Count:
1520

There is never the wrong time to buy a car dealership - there is only a wrong way to buy one.

In August of 2009 Fremont Toyota, in Newark, California set a regional record net profit of over $1,000,000 in one month. The store made more profit in one month than any other Toyota dealership, at any other time in the history of Toyota in the San Francisco Region. Would June of 2009 have been a "bad time to buy that dealership?"

The bible tells us-- "If you wait for perfect conditions, you will never get anything done." Ecclesiastes 11:4

Almost every car dealership that closed in the past two years was bought or established during "the good times." Times when the owners and the experts thought was "the right time."

On October 20, 2008 Automotive News ran a front page story on the fellow that was building a Toyota dealership on the freeway, across from the Oakland Coliseum - a $35 million store, with five floors and a four-story glass showroom. The experts proclaimed that the dealer-- "He has a broader vision about the relationship between real estate and car dealers than you would ordinarily find."

On February 24, 2009 ***The Oakland Tribune*** reported-- "New Toyota dealership in Oakland closes". In that article the dealership's customer relations manager lamented-- "I'm kind of in a state of shock because we thought we had such a bright and opportunistic future here, and with this, it just leaves an empty taste... "

When one analyzes the situation, the dealership was supposed to fail. For a plethora of reasons, its success would have been contrary to the laws of nature. What is interesting is that the factory approved it, the lenders financed it, and the trade publications applauded it-- all while the dealers in the area predicted its failure. Analyzing that situation is left for another article.

There are only two basic factors in buying a dealership that will help ensure success for the long term-- (1) How it is bought-- and (2) How it is managed.

Each factor has a story, but those are the two keys. How the dealership is bought and how it is run will determine its success or failure.

Buying a Car Dealership

What is the right way to buy a car dealership in bad economic times?

In the "good times," buyers were paying premiums for dealerships, based upon brand names, pretty buildings, nice locations, and so forth.

The fact is, in good times or bad, dealerships should be valued in the same manner-- by how much the buyer expects to earn after the purchase. In other words, upon expected ROI (return on investment) - not the brand, or the building, or the location.

Determining what a store can earn after its purchase encompasses more than math. Regardless of the number of times the "multiple of earnings theory" has been proved wrong, members and associates of the trade, along with may trade publications still perpetuate the myth that the purchase of a dealership can be that effortless.

As a natural consequence of the ROI method, purchase prices will fluctuate because one would tend to expect to make more during "good" times, versus "bad." Consequently, when one states that the values for blue sky or goodwill are dropping, their statement has nothing to do with the "value" of the dealership. Furthermore, there is no information in the foregoing statement to help one decide a reasonable value to pay for a dealership.

If a dealer is going under and throws a prospect the keys to the building and says-- "It's yours. I just want out." That act does not make the dealership worth more or less. The questions a buyer has to ask are-- (a)" what is it going to cost me to open the doors?"-- and (b) "what do I think I will earn after I own the store?" In other words-- What is my expected return on investment?

At one time there was a dealer group in Englewood to whom we presented an offer for the existing dealer to pay us $2,000,000 to take it over. The offer was based upon our projections of what we would lose while we tried to turn the store around. The dealer refused and ended-up losing a several million before the store went under. The old buildings are now the home for a church. It is probably fitting that the site is now hallowed ground.

The rules for determining value are the same as we wrote in the following Ezine articles--

- ***Automobile Dealerships - How to Value Them***
- ***Investing in Car Dealerships - Doing Your Homework***
- ***Investing in Car Dealerships - How to Do it Right***
- ***Automobile Dealerships - Valuing Blue Sky***

The Five Biggest Mistakes Purchasers of Car Dealerships Make

Thinking when they verify earnings they have accomplished something. The truth is, what the seller made or lost does not matter. A plethora of detail and formulas need to be applied to determine what the new owner can net. What rent factor PNUR can the store afford? Do those numbers correlate to the percentage of gross requirements?

Overestimating vehicle sales projections. The first question is-- "What can the new owner realistically retail?" We have seen too many dealerships that went under because the buyer could not accurately predict potential sales. On more than one occasion we have seen factories and lenders approve dealerships where the prospective purchasers projected sales volumes that exceeded the volume of the area's historical sales leaders.

Famous buyers thinking their name can turn-around a dealership, or sell cars. We can name more unsuccessful, former car dealers that are famous, than successful car dealers that are famous. We have one photo that depicts a famous athlete getting a business award from the President of the United States, the year before the factory closed his stores. Either nobody saw it coming, or nobody cared.

Thinking that buying a store at a low or zero multiple of earnings means they got a bargain. The biggest misconception of a bargain is when the factory awards a new point. Most people think they got something for nothing. They really did not. The ones that do succeed, however, usually succeed because of the timing and the location - not because of the dealer.

The fact is, it takes about a year to build the service department of a new point, yet the dealer must capitalize the store as though it were already operating on 8-cylinders. In many instances, a new point suffers through months of losses until, if ever, it finally becomes a successful store. In other instances, it is the second owner that makes a go of it and in some instances, such as the Englewood store mentioned above, the point goes away.

The savvy purchaser understands that there is a value to buying a dealership that is in the yellow pages, has a loyal service base and repeat customers. The main value is that the day after the store is sold there are people lined-up for service, people buying parts and customers coming back to the store. That is worth a bonus (blue sky) to the owner even if the store has been losing money.

The fifth major mistake is thinking there is some "magic" formula that will make the store successful. The only formula that will work most of the time is a mixture of hard work and knowledge of the retail automotive business. Each of those words is an operative word-- "retail" and "automotive." Knowledge of another business is not enough.

One last bit of advice to rookies. When making changes in the retail automotive business act swiftly. Erasers are made because people make mistakes. I have yet to meet the person who has never used one, although in today's world one might substitute the word "eraser" with "backspace" or "delete. When a mistake is made, the trick is to act quickly. Do not hesitate to correct errors and bad decisions.

That advice has been around for thousands of years, both in the proverbs one learns as a child (such as "A stitch in time, saves nine" and "He who hesitates is lost," and so forth), and in the bible Eccleasticies 12:12 "But, my son, be warned-- there is no end of opinions ready to be expressed. Studying them can go on forever and become very exhausting!"

In summation, do not hesitate to buy a car dealership in a bad economy, just buy it correctly.

"A dealership should be bought for one reason and one reason only-- to make money. It should not be bought because it is close to home-- because the buyer likes the franchise-- partners wants to provide a job for a relative-- or, because the building is attractive. A dealership is purchased to make money and, in order to make money, it has to be "bought right". John Pico, *A Practical Guide to Buying and Selling Automobile Dealerships*, National Legal Publishing Co. (1989), at 2-4.

That was written twenty years ago. It was true then and it is true today.

- - - -

John Pico served as a court appointed "Consultant to Debtor" in bankruptcy cases, a "Court Appointed Mediator" in automotive disputes, the "Court Appointed Arbitrator / Appraiser" in partnership disputes, a "Court Approved Consultant to Receiver" in a check-kiting case, as a "Superior Court Mediator" in dealership/lender litigation and has been recognized as an expert witness on both State and Federal levels.

He has consulted on upside-down positions of over $50 Million, out of trust position of over $4 Million and a bank overdraft of $30 Million. Since 1972, Mr. Pico has completed over 1,000 automobile dealership transactions, whose combined values exceed One Billion Dollars.

In 1986, he authored and National Legal Publishing Company published the nation's first book on Buying and Selling Automobile Dealerships. You can view his biography at http://www.advisingdealers.com

Josh Pico has a Bachelor of Arts degree from Johns Hopkins University, where he maintained a 3.1 GPA while playing four years on their NCAA, Division I National Championship Lacrosse team. He was captain of the state champion Lawrenceville School lacrosse team, in New Jersey.

Mr. Pico started working with car dealers in 2006, as a consultant with Automotive Advisors of America, Inc., during which time he researched, analyzed and drafted prospectus for the purchase and sale of dealerships and participated in a number of business closing involving both foreign and domestic dealerships.

Now, as a Senior Consultant with Advising Automobile Dealerships LLC, in addition to assisting with the mergers and acquisitions of dealerships, Mr. Pico has researched and analyzed demographic, financial and product data in connection with appraisals and valuations of Honda, BMW, Mercedes-Benz, Volvo, Toyota, Subaru, Chevrolet, Ford, Dodge, Chrysler-Jeep, Pontiac, Buick, GMC and Cadillac dealerships.

He plans for a future in law.